

## ENFORCEMENT OF JAPANESE SECURITIES LEGISLATION

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### 1. Introduction

As in most advanced countries, protection of investors is one of the major national goals in Japan. To achieve this protection, the Securities and Exchange Law<sup>1</sup> was enacted in 1948. The Law assumes that it will be enforced by various bodies: by the government through its licensing, reviewing and monitoring power; by the courts through injunction and civil and criminal decrees; by self-regulatory organizations such as stock exchanges and the securities dealers association; and by private persons through damage suits against those who have violated the law.

This basic structure, so far as the statutory scheme is concerned, appears much the same as its United States counterpart, after which the statute was modeled. The only difference is the fortunate absence of federalism in Japan. When it comes to actual practice, however, the picture differs considerably on the Japanese side of the Pacific Ocean from the U.S. side.

In this paper, the writer tries to sketch how the Japanese Securities and Exchange Law is actually enforced. Section 2 describes briefly the sources of law upon which the enforcement is based and the organization of various regulatory bodies. Sections 3 and 4 give a picture of how the enforcement mechanisms operate to prevent securities fraud in some selected areas of great importance: the issuing process and disclosure problems in Section 3, and the secondary market in Section 4. Some cases of securities fraud are described in Section 5 for the purpose of showing how the law has responded after the fact.

Limited space prevents the discussion in this paper of the Securities Investment Trust Law<sup>2</sup> and the Law on Foreign Securities Firms.<sup>3</sup> Although each of these statutes has special features of its own, one may infer their general modes of operation from what is described here about the Securities and Exchange Law.

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## 2. The regulatory mechanism and its legal basis

### A. Statutory framework

#### (1) Law and rules

While the Securities and Exchange Law contains more than two hundred articles, many of them are not self-executing, but effective only when implemented by cabinet rules (*seirei*) and/or ministerial rules (*shōrei*). Cabinet rules, which provide rules in areas delegated by the statute, must be passed by the cabinet, signed by the minister concerned and the prime minister as well, and promulgated by the Emperor.<sup>4</sup> Ministerial rules are signed and promulgated by the minister concerned (the Finance Minister in the case of the Securities and Exchange Law) to provide rules in areas delegated by the statute or by cabinet rules.<sup>5</sup>

For example, the Securities and Exchange Law simply prohibits stabilizing transactions in contravention of a cabinet rule.<sup>6</sup> In turn, the cabinet rule sets forth detailed provisions concerning permissible stabilization transactions,<sup>7</sup> and a ministerial rule provides filing and reporting requirements with respect to a stabilization transaction.<sup>8</sup>

#### (2) Releases

Like the U.S. Securities and Exchange Commission (SEC), the Director of the Securities Bureau of the Ministry of Finance has issued numerous releases (*tsūtatsu*) with regard to the construction of the Securities and Exchange Law and the rules issued thereunder. Approximately ten have been issued each year. Many of the releases are addressed to the directors of the regional financial bureaus (see B(2), *infra*), and give instructions for handling a particular matter. Others are addressed either to the presidents of the stock exchanges, to the chairman of the Securities Dealers Association of Japan or to the chairman of the Japanese Institute of Certified Public Accountants (JICPA). Only rarely are releases addressed to specific securities firms, but when a release is addressed to the directors of the regional bureaus, it sometimes is circulated among securities firms, or the Ministry finds an opportunity to explain the import of the release to the securities firms.

In addition, an exchange of correspondence (*jimurenraku*) between the chief of a certain division in the Securities Bureau and regional officers in charge of the matter specified in the correspondence may be publicly released. Of course, this correspondence relates to matters of less importance than those covered by releases.

Releases and business correspondence do not constitute direct sources of law. In practice, however, securities administration is carried out in accordance with them, and it is important to know their contents. While most of them are published and easily available, some of them are kept confidential.

### B. Governmental bodies for securities regulation

#### (1) Statutory provisions

The Securities and Exchange Law provides for its enforcement by the Finance

Minister (*ōkradaijin*). Registration statements, annual, semi-annual and current reports, and tender offer statements must be filed with the Finance Minister. He has power to review them and to issue orders requiring amendments or stop orders if necessary.<sup>9</sup> He also has power to grant and revoke licenses to securities firms, stock exchanges and securities finance companies, as well as to control their business operations.<sup>10</sup> A securities dealers association must be registered with the Finance Minister;<sup>11</sup> so must account executives (registered representatives) of securities firms.<sup>12</sup> The Minister supervises the JICPA, and has power to take direct disciplinary action against certified public accountants who have violated the law; he may, for example, revoke their registration with the JICPA.<sup>13</sup>

The Finance Minister is authorized, if necessary in the public interest or for the protection of investors, to inspect issuers, securities firms, securities dealers associations, stock exchanges, securities finance companies and certified public accountants, as well as customers and other related persons.<sup>14</sup>

The Finance Minister may apply to the court for an injunction in urgent cases.<sup>15</sup> Such an application has as yet never been made, but the Minister has made active use of other powers. He has the duty to notify the public prosecutor's office if he suspects that the criminal law has been violated with regard to a securities transaction.<sup>16</sup> On the other hand, he is not empowered to bring a civil suit on behalf of a private party as ancillary relief.

## (2) Securities bureau

The Finance Minister is in charge not only of securities administration but also of other financial matters, such as the national budget, taxation, banking and insurance. Within the Ministry of Finance (*ōkurashō*), securities administration is assigned to the Securities Bureau (*shōkenkyoku*).<sup>17</sup> At present, the Bureau consists of six divisions,<sup>18</sup> with 133 staff members. In addition, a considerable number of staff members are employed in securities administration in ten regional financial bureaus (*zaimukyoku*).

As of the end of 1976, 2,774 corporations filed registration statements and/or annual, semi-annual and current reports with the Finance Minister; 1,135 corporations filed them with the headquarters of the Ministry of Finance, i.e., the Securities Bureau, and the rest filed them with the regional financial bureaus.<sup>19</sup> All amendment or stop orders are issued by the Bureau, regardless of where the registration statement or report was filed. As of the same date, there existed 259 domestic licensed securities firms, but the Bureau itself supervises only 28 of the more important firms (including the Big Four),<sup>20</sup> leaving most of the supervision of the other securities firms to the regional financial bureaus.<sup>21</sup>

Since the Securities Bureau is one of the seven bureaus within the Ministry of Finance, it is easy to coordinate securities policy with other financial policies. Senior members of the staff have experience in various bureaus in the Ministry. This may have both merits and demerits. Policies of critical importance, developed through the coordination of various considerations in the financial area, are gener-

ally accepted within the Ministry and can be readily implemented, as we shall see below in reference to remedial measures taken to cope with the fear of an industry-wide crash in the mid-1960s.<sup>22</sup> On the other hand, such coordination may make it difficult to form a genuine investor-protection policy when it would affect other industries, and may sometimes deter quick responses; examples will be seen below in reference both to the restriction on new issues of securities and to the unsatisfactory enforcement of the rules against insider trading.<sup>23</sup> Rotation of promising members of the staff at short intervals keeps the Securities Bureau from becoming the industry's captive, and helps the development of securities policies and the making of decisions from a broad perspective, but the short stay of staff members may serve to restrict expertise and continuity in securities administration.<sup>24</sup> On the whole, thus far, the merits of the system have outweighed its demerits because of the staff's high competence and industriousness.

### (3) Auxiliary boards

The Securities and Exchange Council (*shōkentorihi shingikai*) is one of the organizations attached to the Ministry of Finance. Its purpose is to study and consider important problems with regard to securities transactions,<sup>25</sup> and it consists of 13 part-time members appointed by the Finance Minister for a two-year term.<sup>26</sup> At times the Council sets up a temporary subcommittee, recruiting experts from the outside to study and consider a specific problem.

Since its birth in 1952, the Securities and Exchange Council has made a number of studies and recommendations which have produced amendments to the Securities and Exchange Law and the rules thereunder, have affected the rules and regulations of self-regulatory bodies, and have been reflected in the enforcement practices of the Securities Bureau. Some of the Council's opinions relate to areas, such as the tax system, which are outside the securities regulation system but have significant impact upon it.

The Securities Bureau serves as a secretariat for the Securities and Exchange Council.<sup>27</sup> The Bureau staff makes basic investigations, collects statistics and prepares drafts of the Council's opinions.

In the accounting area, the Financial Accounting Council (*Kigyōkaikai shingikai*) plays an important role. This council is composed of not more than 40 members, also part-time, appointed by the Finance Minister for a two-year term.<sup>28</sup>

The Financial Accounting Council and its predecessor have, since 1947, formulated several sets of accounting principles and standards, such as the Financial Accounting Principles and the Consolidated Financial Statements Principles, both of which have been embodied almost verbatim in statutory rules.<sup>29</sup> These principles, and the annexed official comments by the Council, have given direction to accounting practice in postwar Japan. The Council has also issued a series of opinions appealing for coordination of the Financial Accounting Principles with the Commercial Code and tax statutes, many of which have resulted in amendments to those statutes.

The Securities Bureau serves as a secretariat for the Financial Accounting Coun-

cil as well.<sup>30</sup> Here, accounting professors, rather than the Bureau staff, seem to have been most influential in the Council's work.

Another body that is attached to the Ministry of Finance is the Certified Public Accountants Inquiry Council (*Kōninkaikeishi shinsakai*), composed of ten part-time members appointed by the Finance Minister for a two-year term.<sup>31</sup> This Council investigates and considers important problems with respect to the certified public accountant system. It takes disciplinary action against CPAs and administers CPA examinations.<sup>32</sup>

### *C. Self-regulatory organizations*

#### *(1) Stock exchanges*

There are now eight stock exchanges in Japan, of which the Tokyo Stock Exchange is by far the most significant.<sup>33</sup> It is true that, as will be seen below, stock exchanges are self-regulatory bodies with power over issuers and members, but the degree of self-regulation is quite different from that of their British counterpart. The Finance Minister holds the power of life and death over Japanese stock exchanges.

The existence of a stock exchange is dependent upon a license granted by the Finance Minister, who reviews each application in light of the exchange's rules, organization and location.<sup>34</sup> The Minister's approval is necessary for a stock exchange to amend its constitution or other rules, and to list or delist a stock.<sup>35</sup> The Minister may order an exchange to amend its constitution or other rules, to list or delist a specified stock, or to dismiss an officer.<sup>36</sup> If a stock exchange violates the statute, rules or administrative orders, or fails to enforce its rules vis-a-vis a member firm or issuer that has violated the Securities and Exchange Law, an administrative order or the exchange's rules, the Finance Minister has the power to revoke the exchange's license, suspend its operations or order it to dismiss one or more of its officers.<sup>37</sup>

No case has been reported thus far where the Finance Minister has taken enforcement action against a stock exchange by making use of the powers enumerated above. This does not mean, however, that stock exchanges have always performed their mission perfectly. The Securities and Exchange Council, in its 1967 report, pointed out that the operation of stock exchanges had not always been carried out in the public interest and for the protection of investors, and urged that the number of non-member directors be increased and the power of the president be enlarged.<sup>38</sup> The stock exchanges have effected reforms along these lines.<sup>39</sup>

Recently, major stock exchanges have persuaded public figures with experience in securities administration to become their presidents.<sup>40</sup> With such strong leadership, stock exchanges have succeeded in increasing their authority over issuers and member firms. At the same time, the Securities Bureau staff has placed more trust in the stock exchanges, and has been able to dispense with issuing as many detailed instructions and guides.

The eight stock exchanges have acted in concert. For instance, the Tokyo Stock Exchange first amends its constitution or rules, obtaining approval from the Finance Minister for the change. The Osaka Stock Exchange does the same after one or two days, and then the other exchanges follow suit. In this way, the constitutions and rules of the eight stock exchanges are almost identical.

### *(2) Securities Dealers Association*

At present, all of the 259 securities firms throughout Japan are members of a single association: the Securities Dealers Association of Japan (*Nippon Shōken-gyōkai*).<sup>41</sup> There is thus no need for rules, such as the SECO rules in the U.S., to regulate securities firms that are not members of a self-regulatory organization.

The Finance Minister's supervisory power over a securities dealers association is similar to his power over a stock exchange, except that a securities dealers association is not licensed by, but is registered with, the Finance Minister.<sup>42</sup>

The Securities Dealers Association of Japan has its Constitution, Rules of Fair Practice, Uniform Practice Code and other rules and resolutions of its board of directors, all of which bind its member firms. The Association requires its member firms to have their account executives (registered representatives) take its qualification test prior to their registration with the Finance Minister.<sup>43</sup> Because of the limited scale of the over-the-counter market in Japan, the role of the Association is less important than that of the U.S. National Association of Securities Dealers.<sup>44</sup>

Aside from self-regulation by the Association, it has become a common practice for major 'universal' securities firms or companies to agree to formulate autonomous rules (*jishu* rules) governing various aspects of their business conduct.<sup>45</sup> We may easily imagine that the Securities Bureau has had some part in formulating such rules, in spite of its public denial.

### *(3) Institute of Accountants*

The history of the Japanese Institute of Certified Public Accountants (JICPA—*Nippon Kōninkaikeishi-kyōkai*) dates back to 1953 when it was formed as a voluntary nonprofit corporation pursuant to the Civil Code. By 1965, nearly 80% of Japan's CPAs were members. In that year, the Certified Public Accountants Inquiry Council recommended that the law be amended to reorganize the JICPA. Immediately after the 1966 amendment of the Certified Public Accountants Law along the lines of this recommendation, the new JICPA was founded as a self-regulatory organization with compulsory membership of all CPAs.<sup>46</sup>

The JICPA is required to set up a Qualification Inquiry Committee (*shikaku-shinsakai*) to inquire into the qualifications of a CPA whom the Institute proposes to refuse to register.<sup>47</sup> The Committee consists of five members appointed by the Chairman of the Institute and approved by the Finance Minister. Among the five must be included the Chairman himself and a member of the Ministry of Finance staff.<sup>48</sup>

The Finance Minister has power to set aside a resolution of a general meeting of the Institute which is against the law, the rules of the Institute or the public interest, and to order removal of any officer who has violated the law or the rules of the Institute, or who has acted against the public interest.<sup>49</sup>

### 3. Regulation of new issues and disclosure

#### A. Selection of issuers

The Securities and Exchange Law, like the U.S. model, is based upon a philosophy of disclosure. An issuer may sell its securities in a public offering, no matter how bad its financial condition may be, so long as it meets the disclosure requirements. It is the investors who must decide whether or not to buy the securities, basing their judgments on the disclosed information. This is the law on its face, but in reality an inferior issuer is not permitted to market its securities, and even a blue chip issuer cannot market its securities at will when money is tight. This is true not only because stock exchanges set up substantive criteria for listing and underwriters are reluctant to handle unsaleable securities, but also because new issues are 'adjusted' taking into account a number of considerations. Moreover, the 'adjustment' seems to be colored with a quasi-public interest, so to speak. Let us see briefly who makes such 'adjustments' and how they are made.

#### (1) Capital stock

When an issuer wishes to increase its capital by issuing new shares, either through a public offering or a private placement, it has to complete the 'application form for issuing new shares' (*shinkabushiki-hakkō mōshikomisho*) and file it with the managing underwriter five months before the proposed issue date. The application is reviewed by a conference consisting of the executive vice-presidents of each of the Big Four (actually in many cases the conference is attended by the heads of their underwriting departments) on behalf of the Conference Concerning Coordination of Capital Increase (*Zōshi no chōsei ni kansuru kondankai*), which reflects the interests of the government and various industries.<sup>50</sup> A by-law of the Conference provides criteria for issuing new shares through a rights offering, ranging from the price at which the new stock may be issued to the net profit that the issuer must be earning, with limited exceptions for some industries.<sup>51</sup> The Securities Bureau, in its 1969 release about underwriting, urges underwriters to abide strictly by this by-law.<sup>52</sup>

The practice of raising capital by issuing new shares at the current market price (with a discount of approximately 8%) has become more and more popular since the late 1960s, and has replaced the previous practice of rights offerings at par. As a result, underwriters have set up autonomous rules which provide that they will refrain from underwriting new shares of issuers which fail to meet the criteria stipu-

lated in the rules with respect to dividends, earnings and free distribution of shares.<sup>53</sup>

The Securities Bureau has repeatedly taken the position that underwriters should exercise due diligence to assure that their assistance in marketing is given only to issues of good quality.<sup>54</sup> Because of the lack of litigation by investors, underwriters have tended to neglect their responsibilities in spite of their strict statutory liability.<sup>55</sup> In response to the warnings by the Securities Bureau, underwriters, represented by the Big Four, entered into an agreement with the JICPA with respect to the issuing of comfort letters.<sup>56</sup> Nowadays, managing underwriters dutifully request answers by the issuer to their questionnaires and secure the documents necessary to review the issue, including a comfort letter from the auditing CPA. However, due diligence reviews are not inspired by the fear of damage suits and must be continually encouraged through administrative guidance.<sup>57</sup>

The selection of issuers, both quantitative and qualitative, through coordination based upon autonomous rules of the securities industry, is designed not merely for investor protection but also to achieve broader financial policies, such as inducing capital to flow into the industries that are deemed most desirable from the viewpoint of the national economy. Moreover, the autonomous rules seem to be built into the enforcement policy of the government.<sup>58</sup> To this extent, the *laissez-faire* principle in the capital market has been modified.

## (2) Debt securities

Issues of corporate bonds and debentures are also coordinated in a manner similar to that just described about new stock issues. Here the so-called Flotation Conference (*Kisaikai*) appears on stage, composed of representatives of the Big Four and the major trustee banks. Several levels of its subordinate bodies filter applications for bond issues before they reach coordination by the Conference. Usually coordination is carried out taking issuers' needs into consideration, but on some occasions when money was very tight, the Ministry of Finance and the Bank of Japan have rendered assistance in coordinating applications for debt issues. At any rate, a corporation with less than four billion yen of net assets is not qualified to apply.<sup>59</sup> Once selected, the terms of issue of the debt securities of a particular corporation are determined almost automatically according to the rating criteria laid down by the Conference.

It goes without saying that the terms of issue of corporate debentures are closely linked with the level of interest rates. The Ministry of Finance, the Bank of Japan, and the Federation of Economic Organizations are among the bodies that may influence the terms of issue. The Bond Underwriters Association (*Kōshasai Hikiu-kekyōkai*), a membership organization of 62 underwriting firms, has made a general survey of the procedures used in fixing the terms of issue of debt securities. This Association and the Flotation Conference have taken steps to improve the methods of determining the ratings of particular issues, and to increase the permissible variations in issue terms once an issue has been given a rating.<sup>60</sup>



## B. Securing Adequate Disclosure

### (1) Review of filed statements

The following are required to be filed with the Finance Minister: registration statements (*yūkashōken todokesho*), periodic reports (*yūkashōken hōkokusho*), semi-annual reports (*hanki hōkokusho*) and current reports (*rinji hōkokusho*).<sup>61</sup> Except for current reports, these statements and reports must contain financial statements that have been audited by independent certified public accountants.<sup>62</sup>

The Finance Minister reviews these statements and reports, and if he finds a false statement or an omission of a material fact, he may order the issuer to file an amendment.<sup>63</sup> He is also empowered to issue a stop order with respect to a registration statement.<sup>64</sup> When an issuer files an amendment to one of its periodic reports, it must promptly announce the fact in a daily newspaper.<sup>65</sup> In addition, if the Finance Minister finds a material misstatement in a registration statement or a periodic report, he has power, after notice and an opportunity for a hearing, to issue a stop order or extend the waiting period, even for subsequent public offerings by the same issuer that are filed within one year after the filing of the untrue statement or report.<sup>66</sup>

Prior to 1965, the staff of the Securities Bureau made a preliminary review of a registration statement before it was formally filed, in order to eliminate the necessity of amendments to correct inadvertent errors committed by inexperienced applicants. Even today, some issuers consult with the Bureau staff with respect to the calendar of prospective financings. The number of such consultations, however, has diminished considerably as issuers and underwriters have become accustomed to the preparation of registration statements. The same is true with periodic reports.

The staff of the Securities Bureau reviews the statements and reports that are filed with it, paying attention to whether relevant facts are adequately disclosed. When questions arise, the Bureau asks the issuer, the CPA or the managing underwriter for explanations. Where deemed necessary for review, the Bureau asks the issuer or the CPA to furnish related documents, such as the tax return. On occasion, when considered necessary to ascertain the adequacy of the statement, the Bureau carries out inspections pursuant to Article 26 of the Securities and Exchange Law.

Upon finding a statement or report that is not properly prepared, the Bureau usually requests the issuer to file an amendment on the issuer's own initiative. Upon finding a false statement, the Bureau as a rule orders the issuer to file an amendment, takes disciplinary action against the CPA and recommends, among other things, that the CPA decline to audit the same issuer in the future. Where the falsity is extraordinarily gross, the Bureau notifies the public prosecutor's office, and if deemed necessary for the protection of investors, it announces, pursuant to Article 193-2, paragraph 5, of the Securities and Exchange Law, that it will refuse to accept, in whole or in part, registration statements and periodic and semi-annual reports containing financial statements audited by the same CPA. Where the Bureau

finds the managing underwriter's investigation insufficient, the Bureau may take action to improve the underwriter's method of operations, such as assisting it to establish a better system for developing the facts about issuers whose securities it plans to market.<sup>67</sup>

A copy of the proxy form (*ininjō-yōshi*) and the proxy statement (*sankōshorui*) must be filed with the regional bureau in whose jurisdiction the solicitor of the proxy has its domicile, but it suffices to file them simultaneously with the mailing of the proxy materials to the shareholders, which means they are not subject to advance review.<sup>68</sup> The Finance Minister has never resorted to the courts to enjoin the solicitation of proxies or the holding of a shareholders meeting, nor has he ever given publicity to misstatements in proxy materials.<sup>69</sup> It is also strange to note that almost all proxy statements used for the election of directors do not show any financial interest relationship between the candidate and the corporation, and do not disclose any remuneration paid to him, even though these proxy statements have been reviewed by the Securities Bureau.<sup>70</sup> It would be fair to say, therefore, that disclosure by means of proxy materials has not played as important a role in Japan as in the U.S.<sup>71</sup>

## (2) Timely disclosures

A current report is the only means by which investors may become aware of material facts which have taken place subsequent to the last filing of periodic or semi-annual reports.<sup>72</sup> Nevertheless, the facts required to be stated in current reports are confined to quite a narrow range, such as the occurrence of a material calamity that causes damage in the amount of at least 1% of the book value of the assets.<sup>73</sup>

Apart from this, there is no provision in the Securities and Exchange Law or the rules thereunder, nor in any release, that requires timely disclosures. The Securities and Exchange Council, while recognizing the importance of timely disclosures and the likelihood of insider trading if disclosure is delayed, takes the position that no rule regulating timely disclosures should be promulgated as yet, because the criteria for materiality of information and timeliness of dissemination are not always certain. The Council has stated that as experience is accumulated, methods will be developed to cope with this problem, which indicates the Council will rely heavily and place great confidence in the self-regulatory practices developed by the stock exchanges.<sup>74</sup>

In 1974, the Tokyo Stock Exchange issued a circular to its listed issuers, requesting that they abide by its rules on prompt notice, that material information be timely disclosed through a nationwide news medium and that, so far as possible, they notify the Exchange of a prospective disclosure in advance.<sup>75</sup> The Osaka, Nagoya and other stock exchanges followed suit immediately.

This request was ignored when a listed corporation failed to notify the Tokyo Stock Exchange promptly of its application for corporate reorganization in November, 1975, resulting in serious disorder in the market.<sup>76</sup> This disaster caused the

Exchange to press listed corporations through another circular to comply with its rules, especially the one requiring a prompt and accurate reply to its inquiries, and to register with it the name of an executive who would serve as spokesman for the corporation.<sup>77</sup> Since the Exchange was afraid some corporations had mistaken the purport of these two circulars, it issued a third one in April, 1976, to explain in detail its policy about timely disclosures.<sup>78</sup> Admirable as the Exchange's efforts may have been, they amount merely to securing information necessary to its supervision of floor trading, not to disclosures to investors. Therefore, we cannot regard this as a timely disclosure policy in the accepted sense.<sup>79</sup>

On the other hand, the Japanese stock exchanges have been attempting to secure more prompt publication of annual financial statements of listed corporations. Since the 1974 amendments to the Commercial Code, which introduced compulsory CPA audits of annual financial statements before they are presented to the shareholders meeting for approval,<sup>80</sup> most corporations have not given publicity to their financial statements until two months after the close of their fiscal year.<sup>81</sup> Issuers justify the delay of a month on the ground that they should not publicize unaudited figures which may be subject to change.<sup>82</sup> Stock exchanges were upset by the adverse effect of the 1974 amendments, which had been aimed at enhancing investor protection. The Tokyo Stock Exchange repeatedly issued circulars to issuers requesting prompt publication of annual financial statements, and suggested that pre-audit reviews by and closer contact with the CPA firm during the course of the fiscal year would help in achieving this goal.<sup>83</sup> In a recent circular, the JICPA announced its position that an auditor may consent to the issuer's publicizing its annual financial statement even before the audit has been completed so long as the unaudited items and figures are not material and there is no exception to be disclosed.<sup>84</sup>

How these requests will affect practice is not known. The Securities and Exchange Council, though admitting the necessity of publicizing annual financial statements without delay, seems to be sympathetic to the issuers' practice of awaiting the completion of the audit.<sup>85</sup> However, the issuer's justification for the delay referred to above, is unwarranted, for directors may be held liable not because they have given publicity to unaudited annual financial statements, but because they have publicized untrue accounts.<sup>86</sup>

#### 4. Regulation of securities companies and the secondary market

##### *A. Regulation of securities companies*

##### *(1) License system*

Securities businesses may be operated only by stock corporations that have been granted licenses by the Finance Minister.<sup>87</sup> Prior to World War II, broker-dealers,

who could have been individuals, were also required to have licenses.<sup>88</sup> The aborted Securities and Exchange Law of 1947<sup>89</sup> did not alter this phase of the law, but by order of the Occupation forces the Securities and Exchange Law of 1948 adopted a registration system for the first time in the history of broker-dealer regulation. Nostalgia for the old license system, however, was so strong that the 1965 amendments to the Securities and Exchange Law returned the statute to the more familiar type of regulation. This occurred at a time when most broker-dealers were in poor financial condition because of the severe stock market depression of the mid-1960s, which culminated in the Yamaichi failure and the formation of Joint Securities.<sup>90</sup> The Securities and Exchange Council took the lead for this return to the old license system, using the argument that the government, in order to protect investors in a time of severe stock market uncertainty, should have greater power over broker-dealers. This argument won over the contention that tight bureaucratic control would stifle the securities industry.<sup>91</sup>

Under the current regulatory system, a securities firm must have at least one type of license among four specified classes, depending upon the kind of business it engages in.<sup>92</sup> A minimum amount of stated capital is prescribed for the applicant, which may be from one million yen to three billion yen, according to the type and location of its business.<sup>93</sup>

Both positive and negative criteria must be satisfied before a license is granted. The former are quite abstract and permit wide discretion on the part of the Finance Minister. The latter are somewhat more objective. The positive criteria are: (1) the applicant has sufficient financial resources to carry out its proposed business, and the prospect for profits is satisfactory; (2) the applicant, in the light of its personnel, has sufficient knowledge and experience to carry out its business fairly and adequately and has a good reputation; and (3) the proposed securities business is necessary and appropriate, in the light of the volume of securities transactions, the number of existing securities firms and offices, and other economic circumstances in the district where the applicant proposes to carry out its business.<sup>94</sup> Negative criteria are those which disqualify an applicant, such as having stated capital less than the minimum requirement or having a director or supervisor disqualified from serving in a securities firm.<sup>95</sup> The term 'necessary and appropriate' as part of the third positive criterion, if construed literally, would serve to perpetuate a monopoly or oligopoly by existing securities firms. Hence it should be narrowly construed, and come into play only in order to prevent cut-throat competition among securities firms.<sup>96</sup>

The Finance Minister may grant a license with some qualifications if it is necessary in the public interest or for the protection of investors.<sup>97</sup> For example, an applicant proposing to operate as a broker and as a dealer may be permitted to engage in sales of securities on its own account only to the extent necessary to execute customers' orders.<sup>98</sup> In addition, all of the licenses have the following qualification:

The Finance Minister may alter the qualifications attached to this license or attach additional qualifications to it to the extent necessary in the public interest or for the protection of investors.

According to the Securities Bureau, this reservation was expressed in order to clarify the Minister's power.<sup>99</sup>

## *(2) Business and financial soundness*

Although its phraseology is drawn from that rich reservoir of anti-fraud law, U.S. SEC Rule 10b-5, Article 58 of the Japanese Securities and Exchange Law is simply inactive. The Securities Bureau pumps up its regulatory authority vis-a-vis securities firms from several wells, of which two deserve mentioning: Article 50 and Article 54, both being byproducts of the 1965 license revival.<sup>100</sup>

Article 50 prohibits securities firms or their officers and employees from engaging in: (1) solicitation of orders by giving customers an affirmative opinion that the price of the security will rise or fall; (2) solicitation of orders accompanied by a promise that the securities firm will compensate for all or a part of any loss the customer may suffer; and (3) activities in connection with a purchase, sale or other transaction in securities that are proscribed by a ministerial rule as running counter to the protection of investors, impairing the fairness of the transaction or injuring the reputation of the securities industry. Based upon the last empowering clause, a ministerial rule, the Soundness Rule, proscribes: (1) false or misleading representations; (2) solicitation of orders with the aid of a promise to offer certain benefits; (3) effecting a series of transactions which manipulate quotations, giving orders to other firms or accepting orders that, to the firm's knowledge, may manipulate quotations; (4) liquidating the firm's position by counter-sale, if its position was derived from a sale or purchase on its own account against a customer's margin transaction without delivery of cash or securities; (5) an officer's or employee's sale or purchase of securities which takes advantage of non-public information obtained through his position or which is made solely for the purpose of speculation; and (6) certain types of transactions in connection with a stabilization.<sup>101</sup>

Upon finding a violation of these provisions, the Finance Minister may revoke the license of the securities firm, suspend all or a part of its business for a period of not exceeding six months, or revoke or suspend the registration of the account executive.<sup>102</sup> In practice, however, it is quite rare for the Minister to resort to these weapons. Often it suffices merely to give a warning.

The Bill of Rights for customers, the so-called 'suitability' rule,<sup>103</sup> has given birth to a premature baby in the Far East. In December, 1974, the Securities Bureau set forth this principle in its release: a securities firm, when it solicits orders, must take fully into consideration the customer's investment objectives, experience and resources, and must refrain from indiscriminate recommendation of a few stocks.<sup>104</sup> The Securities and Exchange Council in its recent report endorsed this release, but advocated only further improvement of internal controls and

employee education within securities firms.<sup>105</sup> The Securities Bureau said that, when its staff inspected securities firms in 1975, it placed great emphasis on whether the manner of soliciting orders was appropriate.<sup>106</sup> The Securities Dealers Association of Japan promulgated a similar rule which requires, among other things, that member firms keep customer cards containing specified information, such as occupation, age, financial status, experience in securities investment, and investment objectives.<sup>107</sup> It is hoped that this infant will grow to be a statutory rule.

Article 54 relates to the financial soundness of a securities firm. Where a securities firm is in one of the following conditions, the Finance Minister may, to the extent necessary and appropriate in the public interest or for the protection of investors, order it to alter its method of operations, suspend all or a part of the business for a period not exceeding three months, escrow property, or take any other necessary steps: (1) where the indebtedness ratio exceeds or is likely to exceed the maximum ratio stipulated by a ministerial rule (ten to one at the present time);<sup>108</sup> (2) where the amount of borrowing, keeping, lending or holding of securities or other assets contravenes or is likely to contravene the standards of soundness; or (3) where a securities firm is in a financial or business condition stipulated by a ministerial rule as one which it is necessary to correct in the public interest or for the protection of investors.<sup>109</sup>

In order to implement item (2) in the preceding paragraph, a ministerial rule stipulates the following standards of soundness: (1) securities held in the account of the securities firm itself must be limited to the minimum amount necessary to do business, and must be diversified into many stocks and be in liquid form; (2) loans, advances and loans of securities must be restricted to those which are necessary to do business, and their amounts, periods, collateral and other terms must be reasonable; (3) as to deposits, debts and borrowed securities, their amounts, periods, interest and other terms must not be unsound in the light of the financial state of the firm; (4) cash deposited by customers in connection with margin and when-issued transactions must be kept separate from other assets, safely and in liquid form; (5) as to securities deposited by customers, the amount must not be excessive and the securities must be kept securely in safe facilities; and (6) as to fixed assets, their amount must be within adequate limits in comparison with the amount of net assets, and their size, structure and equipment must be reasonable in the light of the business, the number of employees and their location.<sup>110</sup>

The implementation of Item 3 of Article 54, paragraph 1, relates to both financial and business soundness. The Finance Minister may issue a correction order: (1) where the amount of net assets is less than that of stated capital; (2) where the state of current receipts and expenditures is unsound; (3) where the amount of bad debts or other doubtful assets becomes substantial; (4) where a firm, as a matter of business policy, engages in an excessive selling campaign to induce customers to purchase stocks that are in the firm's inventory; and (5) where a firm underwrites securities on grossly improper terms (amount, price, etc.) for the purpose of maintaining or enhancing its position as an underwriter.<sup>111</sup>

It is true that some of the soundness standards are clear-cut and unequivocal, but most of them are phrased in a generalized manner and leave room for wide discretion.

### *(3) Inspections*

The Finance Minister is empowered to have his staff members inspect the business condition, the assets and the books and records of a securities firm, if he deems it necessary and appropriate in the public interest or for the protection of investors.<sup>112</sup> As of the end of 1976, there were 218 staff members engaged in inspection, of whom 38 were assigned to the Inspection Division of the Securities Bureau and 180 to the regional financial bureaus.<sup>113</sup>

A securities firm is subjected to regular inspections every twelve to twenty-four months. In cases of critical importance, extraordinary inspections have been carried out. In both regular and extraordinary inspections, staff members review the books and records that broker-dealers are required to keep.

Each year the Securities Bureau makes a check-list for carrying out inspections. In 1976, the Bureau put stress on : (1) whether the firm's business attitudes vis-a-vis its customers were acceptable; (2) whether its pricing of securities on the market was fair; (3) whether the firm had a sound mix of assets and a sound receipts and expenditures position; and (4) whether the firm's internal controls worked rigorously.<sup>114</sup>

In 1976, the Bureau inspected 442 offices of 137 securities firms.<sup>115</sup> Its general conclusions were that the business attitude of broker-dealers had improved year by year, but that some of them insisted on a 'profit first' policy, neglecting their customers' interests in connection with, among other things, solicitation of orders.<sup>116</sup> It is impossible to assess the extent to which the suitability rule has become rooted in Japanese soil, unless more detailed data are furnished by the Bureau's annual reports.

In addition to the Securities Bureau's inspections, each stock exchange and the Securities Dealers Association of Japan regularly and on special occasions inspect their respective member firms.<sup>117</sup>

## *B. Market surveillance*

### *(1) Surveillance mechanism*

In order to maintain fair and free pricing of securities in the market, the government, the self-regulatory bodies and the major securities firms have united against the common enemy, fraudulent and manipulative practices.

The Securities Bureau delegates eleven securities exchange controllers (*torihikisho kanrikan*) to the eight stock exchanges (two each to Tokyo, Osaka and Nagoya and one each to the other five).<sup>118</sup> In 1972, the Bureau established a three-man special command team, informally referred to as 'market watchdogs' (*shijō kanshihan*), who now are assigned to its Secondary Market Division.<sup>119</sup> The securities exchange controllers and market watchdogs, partly because of their small

number, apparently play only a passive role, directing stock exchanges or securities firms to investigate specified matters upon receiving notices from these exchanges or firms that raise questions. They also give instructions to exchanges and securities firms for improvements in their internal control systems.<sup>120</sup>

Aside from this, the Bureau's regular inspection of securities firms mentioned above is another method of ferreting out suspicious practices. For example, inspectors stress in these inspections the search for manipulative conduct on the part of securities firms, issuers and their related persons in connection with new issues; on the part of securities firms when they are distributing large blocks of securities; on the part of 'peculiar' customers;<sup>121</sup> or on the part of anyone taking advantage of inadequate disclosure or false information.<sup>122</sup> Upon finding something unusual with regard to a specific stock, the Bureau carries out an extraordinary inspection to determine the cause of a price change, the details of the transaction and the way the price was determined.<sup>123</sup>

Stock exchanges are expected to play a primary role in market surveillance. Each exchange has staff members specifically assigned to watch stock prices. At the Tokyo Stock Exchange, for example, three departments cooperate for this purpose. Staff members of the Floor Department (*shijōbu*) watch stock prices in every post all the time, and, if any irregularity is found, take evidence from the member firm concerned. If necessary, they warn the firm, or request the Market Surveillance Department (*baibai shinsashitsu*) to carry out further investigation. The latter department, when it suspects signs of manipulation or insider trading, orders the member firm to submit sales reports, and holds hearings, if necessary. Where it finds any transaction in contravention of statutes or the Exchange's rules, the Department takes the steps necessary to prevent a recurrence and gives notice to the Securities Bureau. The Member Examination Department (*kōsashitsu*), which is in charge of inspecting member firms, tries to uncover manipulation, insider trading and high pressure distribution of specific stocks in the course of its regular inspection and, if it discovers suspicious transactions, notifies the Market Surveillance Department. Conversely, the Member Examination Department may carry out an extraordinary inspection upon notice from the Market Surveillance Department.<sup>124</sup> The three departments hold regular meetings to exchange information and to study methods of improving their surveillance.

Universal securities firms<sup>125</sup> have been endeavoring to establish their own internal stock watch systems pursuant to their autonomous rules since 1973.<sup>126</sup> For instance, Nomura Securities Company has a six-man corps (a Sales Review Section in its Securities Review Department) to watch the firm's dealings in each stock it has underwritten or is about to underwrite. The Section issues instructions to each of the firm's branch offices to deal cautiously in such stocks, or if necessary, to refrain from dealing in them for a certain period. As for stocks that have nothing to do with the firm's underwriting business, its Stock Department constantly checks whether irregularities have accompanied the firm's transactions. Most of the smaller securities firms have not yet established such an internal watch system.<sup>127</sup>



(2) *Manipulative practices.*

The Securities and Exchange Law firmly prohibits wash sales, matched orders and other forms of manipulation. The sanctions for violations are civil liability, imprisonment at forced labor and/or fines.<sup>128</sup> Stabilizing transactions are permissible only for a limited period, at specified prices and by a limited class of persons.<sup>129</sup> Because of the difficulty of proving the intent of the party concerned, the Securities Bureau has resorted to the Soundness Rule to cope with manipulation.<sup>130</sup>

Since manipulation is most likely to take place during the so-called 'finance period', *i.e.*, between the time that an issuer begins sounding out the underwriter about the feasibility of a new issue and the time that payment for the new issue is made, the Japanese version of the [London] City Code,<sup>131</sup> contained in the autonomous rules of the universal securities firms, focuses upon this period. These rules require that during the period between the announcement of a new issue by the issuer and the payment date therefore the securities firm must refrain, except in lawful stabilizing transactions, from: (1) purchasing the stock for its own account or the account of related persons (*i.e.*, directors, executives, major shareholders and affiliated corporations); (2) accepting orders to purchase the stock for the account of the issuer's related persons;<sup>132</sup> and (3) soliciting purchases of the stock through the firm's recommendation.<sup>133</sup>

Some securities firms even extend the second of the above autonomous rules. At least one firm refrains from accepting orders to purchase the stock for the account of the issuer's related persons and the issuer's customers on the issuer's request during the period between the time when the issuer decides upon the new issue (even before its announcement) and the time when the price of the stock is no longer affected by any stabilization activity (even after the payment date).<sup>134</sup>

Universal securities firms also agree that they will carefully watch the price movement, sales volume and details of sales in the stocks they underwrite during the period between the announcement of the new issue and the payment date.<sup>135</sup> The purpose of this autonomous rule is to eliminate potential misconduct that might arise from their dual roles of underwriter and broker. The rule is comparable to the so-called 'Chinese Wall' within U.S. firms. As we have already seen, the universal securities firms have established their internal watch systems pursuant to these autonomous rules.

When they sound out the Bureau with regard to a prospective new issue, an issuer and its managing underwriter are required to submit a joint undertaking to the effect that the stock has been priced fairly and that both parties will carefully watch the price movement in the future. The Bureau requests a confirmation by the issuer, at the time the amendment to the registration statement fixing the issue price is filed, to the effect that the issuer has paid careful attention to the price movement.<sup>136</sup>

An issuer customarily mails a letter to its related persons stating that they are prohibited from purchasing the stock for a specified period (during which stabiliz-

ing transactions may take place) and asking that they abstain from purchases or sales of the stock from the date of the letter (even before the beginning of the stabilizing period) to the payment date. The managing underwriter keeps a copy of this letter.

### *(3) Insider trading*

It would be fair to say that one of the typical fraudulent practices in the securities field, insider trading, was not regarded as immoral until a vast number of articles and columns burst into print, galvanized by the famous U.S. cases involving Texas Gulf Sulphur Co. and Merrill Lynch.<sup>137</sup> It is true that the Securities and Exchange Law contains a provision compelling directors, supervisors and 10% shareholders to disgorge their short-swing profits,<sup>138</sup> but the 1953 amendment deprived the provision of its teeth by eliminating the insiders' duty to notify the Finance Minister as to changes in their holdings.<sup>139</sup> As far as the writer knows, there has been but one case, which is unreported, where this provision was resorted to, and that was in connection with an internal management conflict.<sup>140</sup> As we have already seen, the Japanese version of Rule 10b-5, Article 58 of the Securities and Exchange Law, has remained dormant.

The Securities and Exchange Council, while urging that stringent regulation of insider trading is necessary in order to make timely disclosures a reality, irritates conscientious people by nonchalantly stating at the same time that it is sufficient to make people recognize that insider trading is immoral because the new morality will then become the basis of practice. According to the Council, considerable progress has been made by the government, stock exchanges and securities firms through improved stock watch systems and the review of sales orders at the time they are received.<sup>141</sup>

In 1971, the Securities Bureau warned the chairman of the then Federation of Securities Dealers Associations that securities firms should be cautious in accepting orders from insiders.<sup>142</sup> The Tokyo Stock Exchange issued a circular to its listed issuers in 1972, calling attention to Article 189, the short-swing profit provision.<sup>143</sup> Three months later, the Exchange repeated the warning, pointing out that the general public was increasingly concerned over transactions in the securities markets.<sup>144</sup> As has been already noted, the twelve universal securities firms agreed upon autonomous rules to establish internal stock watch systems, and, pursuant to these rules these firms will refuse orders from related persons when, to the firm's knowledge, they were based upon inside information.<sup>145</sup>

The government, stock exchanges and major securities firms may have taken necessary steps when suspicious transactions were discovered, but no publicity has been given to such cases, perhaps to save face for the unlucky scapegoats or for fear of losing the public's confidence in the stock market. Bearing this and the Council's irresolution in mind, wouldn't those warnings cited above sound like mere dog howlings? It is high time that a new and effective statute is adopted.<sup>146</sup>

#### *(4) Cooling the overheated market*

The securities industry as a rule welcomes a bullish market. If the market is exceedingly excited, however, it is usually the public investors who are hurt, as they board the rising elevator near its top after the professional operators have gotten off.

In November, 1972, stock prices rose at an accelerated rate: the Tokyo Dow rose from 4781.48 at the beginning of the month to 4909.24 in the middle of the month, and to 5207.94 at the end of the month. Average sales volume per day in that month on the first section of the Tokyo Stock Exchange reached over 556.6 million shares (year-round average per day was approximately 197.4 million shares in 1971, and 327.8 million shares in 1972).<sup>147</sup> The Securities Bureau, on December 1, 1972, gave the following instructions to the 22 securities firms under its direct control: (1) they were not to increase loans to customers for margin transactions in excess of the balance at the end of November; and (2) the ceiling for holding securities for their own account was to remain the same as in 1971, despite the otherwise permitted expansion because of the increase in their net assets.<sup>148</sup> The Bureau also notified investment trust companies of the suspension of the otherwise permitted expansion of the maximum amount of their trust funds. It further requested underwriters to limit the number of shares allotted to persons designated by the issuer to half of the total number of new shares, and to set the price for new issues of outstanding stock as close as possible to the market price at the time of issue. Lastly, the Bureau requested commercial banks not to increase their percentage of holdings in a stock.<sup>149</sup> On the same day, the stock exchanges raised the cash deposit ratio of bond for margin transactions to a flat rate of 20%.<sup>150</sup>

Since the fever continued in spite of these measures, the Ministry of Finance revised its rule on margin transactions to raise the margin rate (bond) from 60% to 70%. The stock exchanges increased the cash deposit required to be made by the securities companies to a ratio of 30%. Moreover, on the same day, January 9, 1973, the Deputy Minister of Finance summoned the presidents of the Big Four to warn them to take positive steps to control speculative activities in their firms and to make efforts to calm the securities market.<sup>151</sup> Mr. Segawa, then chairman of the Tokyo Securities Dealers Association, issued a circular to the member firms, and Mr. Morinaga, then president of the Tokyo Stock Exchange, published a statement addressed to investors at large and the member firms, both to similar effect and on the same day.<sup>152</sup> As the market had not calmed down, the Deputy Minister, Mr. Segawa and Mr. Morinaga repeated their actions on February 21, 1973.<sup>153</sup> On the same day, the Securities Bureau conducted an extraordinary inspection of several broker-dealers to see whether stock pricing was being distorted because of, for example, speculative funds and/or broker-dealers' operations, as had been suspected by the general public.<sup>154</sup>

Although the Tokyo Dow monthly average did not fall from the peak of 5359.74 on January 24, 1974 to below 5000 until April (4770.54), the average

sales volume per day on the first section of the Tokyo Stock Exchange showed a sharp decline from about 626.2 million shares in January to 316.3 million shares in February, and to 156.5 million shares in March of that year.<sup>155</sup>

### C. Noah's ark

Just the opposite of the preceding account is the story to be told next: measures taken in the face of a desperate bear market. Let us turn back the clock by about a decade before the scene we have just described. After July, 1962, when the Tokyo Dow marked its peak at 1474.83, the stock market slid downward. While it recovered and reached an even higher point at 1634.37 in April, 1963, it thereafter again declined. On July 19, 1963, when President Kennedy proposed the interest equalization tax, stock prices plummeted, and at the end of the month the index was at 1386.98. This so-called 'Kennedy shock' and his assassination in November gave double blows to the weak market, which had already been staggered by the unsatisfactory balance of payments, the increase in the reserve ratio required against deposits, and above all the prevailing forecast of a worsening recession. The matter of greatest concern then became how to defend the 1200 line which it appeared the Tokyo Dow was about to cross.<sup>156</sup>

#### (1) National pools

It goes without saying that an oversupply of stocks in comparison with shrunken demand was the underlying cause of this sluggish market.<sup>157</sup> In order to absorb and freeze the new supply of shares, the Japan Joint Securities Company, Ltd. (*Nippon Kyōdō Shōken Kabushikigaisha*) was formed on January 20, 1964 by twelve city banks, two long-term credit banks and the Big Four.<sup>158</sup> This corporation was registered as a dealer and, subsequently, upon the effectiveness of the 1965 amendments to the Securities and Exchange Law, obtained a license in September, 1967. The corporation's declaration of business policy stated that it proposed, among other things, to adjust supply and demand in stocks, bring equilibrium to the stock market, and thereby develop the capital market.<sup>159</sup>

In addition to its 30 billion yen of stated capital, Joint Securities obtained its working capital by borrowing 100 billion yen from city banks and 67.8 billion yen from Nippon Securities Finance Company, the latter loan having originated from the Bank of Japan with stocks lent by various industries as collateral.<sup>160</sup> With this war chest, Joint Securities bought approximately 1.6 billion shares of about 189.7 billion yen in book value, and subscribed for approximately 200 million new shares of 10.2 billion yen in book value that were allotted to it as a shareholder, and took them all out of the market.<sup>161</sup>

The chilling blizzard of the depressed stock market was so harsh that Joint Securities needed help. Thus another pool, the Japan Securities Holding Association (*Nippon Shōken Hōyū Kumiai*) was organized on January 12, 1965 as a civil partnership by 56 stock exchange member firms.<sup>162</sup> Unlike Joint Securities, the Holding Association was not a dealer, but was organized just to acquire stocks from

investment trusts and the securities firms that had formed the partnership through a limited number of purchases, and to hold them for a period not longer than three years. Purchases from a partner firm were on condition that the seller would buy back the stock for the same price at the time of market revitalization.<sup>163</sup> In addition to the partner's contributions of approximately 17.3 billion yen, the Holding Association obtained loans of 164.6 billion yen from Nippon Securities Finance Company, again originating from the Bank of Japan, and purchased about 2.1 billion shares of about 232.8 billion yen in book value.<sup>164</sup>

In this way, the national unity front, with the mighty vacuum cleaners of Joint Securities and the Holding Association, sucked 3.7 billion shares out of the stock market during the most critical period (amounting to 5% of the total number of shares listed on the first section of the Tokyo Stock Exchange, 74.7 billion shares in 1965). The 1200 line was defended. Securities firms and investment trusts, freed from the heavy load of their holdings and the menace of stock oversupply, were able to devote themselves to their ordinary business, selling and buying stocks, and some elite issuers regained the opportunity to float their shares, though under rather stringent qualitative and quantitative restrictions. Also, with signs of business recovery, the stock price upturn enabled the two pooling organizations to sell their holdings, bit by bit. The Japan Securities Holding Association was dissolved on January 11, 1970, and the Japan Joint Securities Company was dissolved on January 30, 1971, both after having emptied their portfolios, and with huge profits.<sup>165</sup>

Let us draw a curtain by just quoting the Securities Bureau's remarks on these allied operations.

Joint Securities, though a dealer in form, should rather be regarded as an institutional investor in its substance. It is true that its formation and operations were criticized as inconsistent with the principle of a free stock market. But against the background of present-day Japan with its paucity of powerful institutional investors, an institution like Joint Securities may well claim its *raison d'être*.<sup>166</sup>

\* \* \*

The Holding Association is a manifestation of an attempt by securities companies to freeze out excessive shares by themselves, and thereby to improve supply-demand relations. This design, while unrealizable without an understanding and cooperation by financial authorities, is an epoch-making step in the history of the Japanese capital market.<sup>167</sup>

## *(2) Repair the cracked dike*

Against the background just seen, most securities firms were badly off. Yamaichi Securities Company, one of the Big Four, reported a huge deficit in its accounts as of the end of September, 1964. Yamaichi had devoted itself heavily to dealer business and had a long lead on other firms in the race to become managing underwriter for those 'upper middlemen' that had gone public in previous boom years. Overall, this exacerbated its position as stock prices went down, leaving it with a heavy

burden of sticky stocks of lower quality. In November, 1964, the president of Yamaichi Securities was replaced by Mr. Hidaka, a former executive of a long-term credit bank. The new management, while attempting to remedy the firm's situation by reducing the number of its offices and employees, and disposing of idle properties, found it difficult to improve the firm's financial position without outside help.

On May 21, 1965, Yamaichi announced its rehabilitation plan, including a moratorium on interest payments on loans from 18 banks. This aroused serious anxiety among people who associated that step with bank failures in the days of the Great Depression, and a kind of run on the firm took place.<sup>168</sup> There were signs that this run might spread to other firms.

On May 29, the Finance Minister, Mr. Tanaka, granted permission to the central bank to make special loans to Yamaichi pursuant to Article 25 of the Bank of Japan Law.<sup>169</sup> In their press conference the previous day, the Minister and the Governor of the Bank of Japan had asserted their firm resolution to take the necessary steps, stressing the need to protect the public investors, not the need to save the securities firms. Along this line, eight special loans totaling 28.2 billion yen were granted to Yamaichi through three major banks, without any collateral except notes issued by Yamaichi and without any limitation on the loans.<sup>170</sup> This was a first in the history of the Japanese securities industry. The disturbance rapidly calmed down; the emergency had passed.

A year later, on June 11, 1966, Yamaichi announced its revised rehabilitation plan, including scheduled repayments of the special loans. A newly-formed corporation, which obtained the first license as a securities firm under the 1965 amendments to the Securities and Exchange Law, succeeded to the business of the fatally wounded firm.<sup>171</sup> Because of the revived stock market in 1968–69, the new Yamaichi firm made remarkable profits, and paid back the special loans in full by the end of September, 1969.<sup>172</sup>

Taking this costly mishap as a lesson, securities firms, under the direction of the Securities Bureau, have made efforts to ameliorate their condition by putting more emphasis on their brokerage business and reducing current expenditures so as to enable themselves to exist on commission revenues, while keeping their underwriting business within reasonable limits.<sup>173</sup>

## 5. Sanctions: some case studies

There have not been many cases where formal proceedings, judicial or administrative, have been taken under the Securities and Exchange Law. In this Section, we will take a look at some typical cases of such proceedings in connection with serious violations.

### *A. San'yō Steel case*

This case is unusual in that it had immeasurable influence upon not only the

Japanese economy but also on Japanese society at large and brought about amendments to both the Securities and Exchange Law (1966) and the Commercial Code (1974).<sup>174</sup>

San'yō Special Steel Co., Ltd. (*San'yō Tokushu Seikō K.K.*) was one of the leading manufacturers of special steel, with 3,700 employees, 7.38 billion yen of stated capital, and liabilities even to foreign banks. On March 6, 1965, the company applied to the court for relief under the Corporate Reorganization Law, on the ground that it would not be able to honor its promissory notes of 1.8 billion yen that were about to become due without serious impairment of its ability to continue in business.

San'yō Steel had distributed dividends and paid bonuses to its management from 'surplus' for seven consecutive years prior to this application for relief. However, the court proceedings and the Securities Bureau's inspection revealed that the company had had deficits in most of these years, and had made false entries in its financial statements amounting to approximately 13.1 billion yen in total, almost twice the amount of its stated capital.<sup>175</sup> The company had issued new shares to more than double its stated capital in 1960, and the management had thought it necessary to continue dividend distributions in order to satisfy the shareholders and to make additional new issues possible. The company thus devised a plan to create sham profits by adding false sales, hiding some of its manufacturing, general administrative and selling costs and eliminating some liabilities from its books.<sup>176</sup>

The Securities Bureau lodged an accusation in the public prosecutor's office against the company and its president pursuant to the Securities and Exchange Law because of untrue statements in its periodic reports. This was the first time in the history of that law that such an action had been taken.<sup>177</sup> The Bureau also revoked the registration of the certified public accountant who had knowingly given an unqualified audit certificate about the false financial statements of the company.<sup>178</sup> The company brought a civil suit for damages against 15 of its executives, and the court decreed assessments of damages for which the defendant directors and supervisors were liable pursuant to Article 266 of the Commercial Code.<sup>179</sup> However, civil suits by investors based upon the Securities and Exchange Law have never been brought.

### *B. NTV case*

Nippon Television Network Corporation (*Nippon Terebi Hōsōmō K.K.*), with stated capital of 1.2 billion yen, announced on June 24, 1969 its plan to increase the stated capital to 2.5 billion yen by issuing new shares, partly (1.2 billion yen) through a rights offering at par value and partly (100 million yen) through a non-rights offering at the current market price. Upon reviewing the registration statement filed on September 17, 1969 for these new issues, the Securities Bureau found that the company's surplus had been overstated by approximately 896 million yen

through overstating prepaid expenses, hiding certain accrued expenses and underestimating depreciation expenses. At this point, the market price of the stock was already *ex-rights* and at about 1400 yen (the *cum-rights* price had been roughly 2400 yen).

The Securities Bureau feared that exposure of the 'window-dressing' would disturb the stock market. The Bureau simply expected that the new issue project would be withdrawn at NTV's initiative, through persuasion by the underwriters. However, NTV gave up only its scheduled non-rights offering and filed a voluntary amendment to the registration statement in connection with the planned rights offering pursuant to Article 7 of the Securities and Exchange Law. The Bureau accepted this! It merely extended the waiting period pursuant to Article 8, paragraph 3, of the law, and the registration statement became effective on October 16, 1969. Thus, NTV was able blatantly to accomplish its project of raising additional capital funds. The Bureau, on December 17 of the same year, issued an order requiring the amendment of the periodic reports which had been filed by NTV.<sup>180</sup>

The Securities Bureau argues that it does not have any statutory power to suspend an ongoing new issue.<sup>181</sup> It could, however, have applied to the court to issue an injunction.<sup>182</sup> The Bureau also argues that it was not completely sure of the total amount of the falsified figures, which, according to the Bureau's interpretation, is a prerequisite for issuing an order requiring an amendment pursuant to Article 10 of the Securities and Exchange Law. According to the Bureau, it would have taken considerable time to collect all of the evidence and hold hearings before issuing an order, and such a delay would have had worse repercussions than the prompt publication of the issuer's voluntary amendment.<sup>183</sup> But who agrees with this view? Isn't the Finance Minister empowered to issue a stop order<sup>184</sup> for the very purpose of suspending this sort of fraudulent offering? The only consolation is that the Bureau frankly stated the facts and its views in its annual report. One certainly hopes that the Bureau has discarded this sort of timid interpretation.

### *C. Kyōdō Shiryō case*

Kyōdō Shiryō Co., Ltd., a feed manufacturer, with stated capital of 2.3 billion yen, had been listed on the first section of the Tokyo Stock Exchange. On July 26, 1972, the company announced a plan to increase its stated capital to 3.5 billion yen by issuing 11.5 million new shares at par value through a rights offering and 12.5 million shares at current market value through a non-rights offering, with the new shares to be paid for on November 30. The market price of the stock, around 150 yen on July 1, and 177 yen on July 26 when the plan was announced, kept on rising and reached its all-time high of 265 yen on September 22. During this period of less than two months, the stock rose 49%, while both the Tokyo Dow and the stock of another feed manufacturer showed only a 14% rise. After the *ex-rights* date (September 27), the stock remained at about 230 yen, and the company set the issue price for the non-rights offering at 200 yen on November 10. After the



payment date, the stock showed a slight downward movement, while the Tokyo Dow continued to rise until late January of the next year. Average sales volume per day in the company's stock, which had been 226,000 shares in June 1972, increased to 425,000 shares in July, and thereafter decreased, and remained at about 20,000 shares from October on.<sup>185</sup>

The public prosecutor's office instituted a prosecution against the company and two of its executives, and against a branch manager in each of the Daiwa, Nikkō and Nomura securities firms, the first two firms being the managing underwriters for Kyōdō Shiryō. The charge was that the company, with the aid of the securities firms, had manipulated its stock price up to the contemplated issue price in order to raise capital funds on favorable terms.<sup>186</sup> This criminal proceeding is still pending.

The Securities Bureau, after holding hearings on March 29, 1973, suspended the business of the branch office concerned of each of the three securities firms for a period of three days on the ground that these firms had acted in contravention of the Soundness Rule.<sup>187</sup> The Tokyo Stock Exchange imposed the same disciplinary sanction and in addition imposed a penalty of 500,000 yen each on Daiwa and Nikkō and 400,000 yen on Nomura. The Exchange also assigned Kyōdō Shiryō stock to a special post in preparation for its delisting.<sup>188</sup>

#### *D. Nihon Netsugaku case*

This is a case in which a number of audacious violations were committed. Nihon Netsugaku Kōgyō Co., Ltd., a manufacturer of air-conditioning equipment, attracted much attention as a rapidly-moving dark horse; it was formed in 1957, listed on the second section of Osaka Stock Exchange in 1972 and the Tokyo Stock Exchange in 1973, and was 'promoted' to the first section of both the Tokyo and the Osaka exchanges on May 1, 1974, with stated capital of approximately 1 billion yen.

Twenty days thereafter, on May 20, 1974, the company applied to the court for relief under the Corporate Reorganization Law, having dishonored about 500 million yen of its promissory notes. The court appointed a leading accounting firm as an investigator. The police made inquiry and the Securities Bureau carried out inspections. These studies revealed several illegal acts by Nihon Netsugaku.

For three years up to the end of 1973, the company had issued false financial statements that inflated its net profits by 4.24 billion yen. It had recorded fictitious sales, underestimated its construction costs, and so on, thereby concealing large deficits. Based upon these untrue financial statements, the company made three public offerings, in December 1972, June 1973, and December 1973, in which it raised a total of more than 30 billion yen.

It was alleged that officials of Nihon Netsugaku conspired to manipulate the company's stock price, which had fallen from a high of 1470 yen on March 7, 1974 to 960 yen on May 10, affected by bad news about the company. In order to maintain the stock price above 1000 yen, these company officials were said to have

placed a series of buy orders with Yamaichi Securities Co., its managing underwriter, and other brokers whereby they purchased 237,000 shares for the company's account, making use of subcontractors and others as nominees during the period between May 9 and 15.<sup>189</sup>

At the same time, between February 15 and May 9, 1974, four company officials were apparently selling their own shares, 880,000 in total, knowing the desperate financial state of the company.<sup>190</sup>

The court refused to apply the Corporate Reorganization Law on the ground that there was no prospect of rehabilitating the company. The Securities Bureau lodged an accusation against Nihon Netsugaku and nine of its officials. The public prosecutor's office also instituted a prosecution against them. Six of the accused individuals were sentenced to imprisonment for a period of ten months each, with suspension of the sentence for two years.<sup>191</sup> The proceedings against the other three accused, including the president, are still pending.

Two certified public accountants who were found to have given false audit certificates were summarily sentenced to a fine of 150,000 yen each, and were suspended from their business for one year.<sup>192</sup>

The Securities Bureau, after holding hearings on January 23, 1975, suspended the brokerage business of Yamaichi's Osaka branch for two days for violation of the Soundness Rule.<sup>193</sup> On the same day, the Osaka Stock Exchange imposed the same disciplinary sanction plus a penalty of 500,000 yen, and the Tokyo Stock Exchange suspended a part of Yamaichi's brokerage business for the same period. The Securities Dealers Association of Japan imposed a penalty of 500,000 yen on January 27.<sup>194</sup>

## 6. Conclusion

A U.S. SEC staff member might well be surprised at the extreme obedience of Japanese securities companies and issuers. A British merchant banker might well envy the big umbrella the Japanese securities industry enjoys. A U.S. federal judge might wish to be transferred to a Japanese court to get rid of the Rule 10b-5 nuisance. But some U.S. practicing lawyers may wonder what their Japanese colleagues live on.

It is true that the Japanese people are not as litigious as those of the U.S. But this is not the only answer. In Japan, there are no class actions or contingent fees available for investors and securities lawyers. Moreover, the number of attorneys is quite small, 11,035 in June 1977 (the population is approximately 110 million). Readers should understand that, in the light of sparse litigation in the field of securities regulation and the Securities Bureau's patriarchal administration, the demand for more securities lawyers is not strong.

Broker-dealers and issuers may continue to refrain from quarreling with the government. However, investors, who have been silent, may become more talkative

as consumerism rises. A case for class action or group action (*Verbandklage*) is gradually acquiring support, but one hurdle seems to be the decrease in the number of individual investors because of low average stock yields. If issuers continue with a low dividend policy, they will dig their own graves by distorting the foundations of capitalism.

## Notes

<sup>1</sup> *Shōkēntōrihikihō*, Law No. 25 of 1948, as amended by Law Nos. 4 and 5 of 1971 (hereinafter cited as SEL).

<sup>2</sup> *Shōken tōshishintakuho*, Law No. 198 of 1951.

<sup>3</sup> *Gaikoku shōkengaiisha ni kansuru hōritsu*, Law No. 5 of 1971. As to the gist of these two laws and the rules thereunder, see Tatsuta, Securities Regulation in Japan 102–06, 122–24 (1970).

<sup>4</sup> The Constitution of Japan (*Nipponkoku kempō*), art. 7, item 1; art. 74.

<sup>5</sup> National Administrative Organization Law (*Kōkagyōsei soshikihō*), Law No. 120 of 1948, art. 12.

<sup>6</sup> SEL art. 125, para. 3.

<sup>7</sup> Rule for Enforcement of Securities and Exchange Law (*Shōkēntōrihikihō shikōrei*), Cabinet Rule No. 321 of 1965, as amended by Cabinet Rules No. 150 of 1971 and No. 167 of 1977 (hereinafter cited as SEL Enforcement Rule), art. 20 through art. 26.

<sup>8</sup> Ministerial Rule Concerning Filing of Stabilizing Transactions (*Anteisōsa torihiki no todokeide tō kansura shōrei*), Ministry of Finance Rule No. 43 of 1971 as amended by Ministry of Finance Rule No. 61 of 1971.

<sup>9</sup> SEL art. 4 through art. 11; art. 24 through art. 24-3, art. 24-5; art. 27-2.

<sup>10</sup> SEL art. 28 through art. 37, art. 53, art. 54; art. 81 through art. 85-2, art. 111, art. 112, art. 120, art. 154 through art. 156; art. 156-3 through art. 156-14.

<sup>11</sup> SEL art. 67 through art. 78.

<sup>12</sup> SEL art. 62 through art. 64-4.

<sup>13</sup> Certified Public Accountants Law (*Kōninikaishihō*), Law No. 103 of 1948 (hereinafter cited as CPA Law), art. 19-2, art. 30 through art. 32, art. 34–21,

<sup>14</sup> SEL art. 26, art. 55, art. 76, art. 154, art. 156-13; CPA Law art. 33, para 1; art. 34-21, para 2.

<sup>15</sup> SEL art. 187.

<sup>16</sup> Criminal Procedure Code (*Keijisōhōhō*), Law No. 131 of 1948, art. 239, para. 2. Penal provisions are found in SEL art. 197 through art. 207 and CPA Law art. 50 through art. 53-3.

<sup>17</sup> In pre-war times stock exchanges, commodity exchanges, stock broker-dealers and commodity broker-dealers were all under the control of the then Ministry of Commerce and Industry (*Shōkōshō*), the predecessor of the present Ministry of International Trade and Industry or MITI (*Tsūsanshō*). The administration of stock exchanges and stock broker-dealers was transferred to the Ministry of Finance in 1941. In 1948, when the SEL was enacted, an independent agency, the Securities and Exchange Commission (*Shōkēntōrihiki iinkai*) was established after the model of the U.S. SEC. To simplify the administrative structure, however, this commission was abolished in 1952, and its functions were absorbed by the Ministry of Finance. At that time, the Ministry of Finance had only three relevant divisions under its Financial Bureau (*Rizaihyoku*). Constant and rather rapid expansion of these divisions, along with the remarkable growth of the securities industry, were responsible for the creation of the Securities Bureau with five divisions in 1964.

<sup>18</sup> Co-ordination Division (*Sōmuka*); Capital Market Division (*Shihonshijōka*); Corporation Finance Division (*Kigyōzaīmuka*); Secondary Market Division (*Ryūtsūshijōka*); Securities Companies Division (*Gyōmuka*); and Inspection Division (*Kensaka*).

<sup>19</sup> Those domestic corporations whose stated capital is less than 100 million yen and whose securities are not listed on any securities exchange must file their statements and reports with the director of the regional financial bureau of the district in which the corporate head office is located. Ministerial Rule Concerning Public Offering or Secondary Distribution of Securities

(*Yūkashōken no boshū matawa uridashi no todokeide tō ni kansuru shōrei*), Ministry of Finance Rule No. 5 of 1973 (hereinafter cited as 'Registration Rule'), art. 20.

<sup>20</sup> Nomura, Nikkō, Yamaichi and Daiwa; see n. 45 *infra*.

<sup>21</sup> On Delegation of Business Relating to Securities Companies (*Shōkengaiha ni kansuru jimu no inin ni suite*), Ministry of Finance Release (*zōshō*) No. 680, Apr. 1, 1968. The criteria for the Bureau's direct control are that the securities company must have stated capital of 500 million yen or more and that it must have at least one office within the Tokyo district. In addition, some of the 28 companies are under the Bureau's direct control because of their extraordinary nature, although they do not meet these criteria.

<sup>22</sup> See Section 4(C) *infra*.

<sup>23</sup> See Sections 3(A) and 4(B)(3) *infra*.

<sup>24</sup> The Ministry of Finance attracts the highest ranking students who have passed the national civil servant examination of the highest grade, many of them being graduates of the University of Tokyo. These elite members of the staff, listed on the so-called List A, are promoted quickly in a way that gives them experience in many positions in various bureaus, including the position of head of small local tax offices within the first five or six years of their employment. Since a good record in one position is indispensable for the next promotion, they make an intensive study of each new assignment, become expert in a surprisingly short period of time, and are quite careful not to make any mistakes. Other members of the staff, who have also passed a national examination, but not of the highest grade, are listed on the so-called List B and rise in rank less rapidly, in many cases remaining within a single bureau. Since they stay longer in one position and are familiar with jobs closely related to that position, they become real experts and support the continuity of administration in a specified area. See Ikeda, *Ōkurashō Shōkenkyoku* (Securities Bureau, Ministry of Finance) 107 (1969). Until recently, the director of the Securities Bureau was rotated approximately every two years, but now rotation takes place almost every year.

<sup>25</sup> SEL art. 165.

<sup>26</sup> SEL art. 166, art. 167, art. 169. As of May 23, 1977, the members' occupations are as follows: former vice-chairman of the Federation of Economic Organizations; editorial writer of a leading newspaper; president of a housing loan company; president of a securities finance company; professor emeritus of law; president of the Tokyo Stock Exchange; chairman of the Life Insurance Association of Japan; executive vice-president of a leading steel company; executive vice-president of a long-term credit bank; executive director of the Bank of Japan; executive director of the Federation of Bankers Associations of Japan; president of a semi-governmental bank; and chairman of the Securities Dealers Association of Japan.

<sup>27</sup> Ordinance concerning the Securities and Exchange Council (*Shōkensorihiki shingikairei*), Cabinet Rule No. 410 of 1952, art. 2.

<sup>28</sup> Law Establishing the Ministry of Finance (*Ōkurashō setchihō*), Law No. 144 of 1949, art. 17, para. 2; Ordinance Concerning the Financial Accounting Council (*Kigyōkaikai shingikairei*), Cabinet Rule No. 307 of 1952, art. 2, art. 5. At present, the Council has twenty members: six of them, including the chairman, are accounting professors; two are professors of law; two are accountants, i.e., the president and a vice-president of the JICPA; one is the chairman of the Japanese Federation of Tax Consultants Associations; four are representatives of industrial circles; one is vice-president of the Tokyo Stock Exchange; one is director of the Civil Bureau, Ministry of Justice; and three are directors of the Tax Bureau, the National Tax Administration Agency and the Securities Bureau, Ministry of Finance, respectively. In addition, there are sixteen temporary members and three associate members with similar positions and background.

<sup>29</sup> Regulations Concerning the Terms, Form and Method of Preparing Financial Statements (*Zaimushohyō tō no yōgo, yōshiki oyobi sakusei-hōhō ni kansuru kisoku*), Ministry of Finance Rule No. 59 of 1963 (hereinafter cited as Financial Statement Regulation); Regulations Concerning the Terms, Form and Method of Preparing Consolidated Financial Statements

(*Renketzu-zaimushohyō tō no yōgo, yōshiki oyobi sakusei-hōhō ni kansuru kisoku*), Ministry of Finance Rule No. 28 of 1976. These regulations are based upon SEL art. 193. Both the Financial Accounting Principles and the Financial Statement Regulation have been amended several times.

<sup>30</sup> Ordinance Concerning the Financial Accounting Council, art. 9.

<sup>31</sup> CPA Law art. 36.

<sup>32</sup> CPA Law art. 35.

<sup>33</sup> In 1976, the Tokyo Stock Exchange accounted for 84.7% of the volume of shares traded on all exchanges; the next most active was the Osaka Stock Exchange, which accounted for 11.6% of the volume.

<sup>34</sup> SEL art. 81 through art. 83.

<sup>35</sup> SEL art. 85-2, para. 1; art. 110; art. 112.

<sup>36</sup> SEL art. 103, art. 111, art. 119, art. 156.

<sup>37</sup> SEL art. 155, para. 1, item 1.

<sup>38</sup> *Kabushiki Ryūtsūrikō no Seibikaizen ni tsuite* (On the Improvement of Facilities for Stock Trading), 1968 Ōkurashō Shōkenkyoku Nempō (Annual Report of the Securities Bureau, Ministry of Finance) 250–51. Annual Reports of the Securities Bureau are hereinafter cited, with date, as SB Ann. Rep.

<sup>39</sup> 1969 SB Ann. Rep. 172–75.

<sup>40</sup> Although it has not been uncommon that some of the non-member directorships of a stock exchange were filled by former officials of the Securities Bureau, until recently presidents were almost always elected from among member directors. That has changed. The former president of the Tokyo Stock Exchange, Mr. Morinaga, was once deputy minister of the Ministry of Finance and is now the Governor of the Bank of Japan. Mr. Taninura, now President of the Tokyo Stock Exchange, served as deputy minister of the same ministry and as Chairman of the Fair Trade Commission. The President of the Osaka Stock Exchange, Mr. Matsui, was the first Director of the Securities Bureau.

<sup>41</sup> At one time, there were 33 associations of securities dealers, averaging nearly one in each prefecture, and some securities firms were not members of any association. The Securities and Exchange Council in 1964 suggested that in order to achieve more effective self-regulation the multiplicity of associations should be replaced by a new national association of securities firms, and it advocated that membership in the association be required of all securities firms. From 1965 to 1967, the Japan Federation of Securities Dealers Associations and local associations made a study of their future organization and functions, and formulated policies to carry out these recommendations. Tatsuta, *op. cit. supra* n. 3, at 78–79 n. 50. On May 1, 1968, the 33 local associations were integrated into ten new associations, and as of July 1, 1973, these ten were again consolidated into one single association, similar to the U.S. National Association of Securities Dealers (NASD). 1968 SB Ann. Rep. 236–38; 1973 SB Ann. Rep. 89–90. As a result, SEL art. 79, relating to a federation of securities dealers associations, became a dead letter.

<sup>42</sup> SEL art. 67 through art. 78.

<sup>43</sup> The Administration Control Agency (*Gyōseikanrichō*) even suggested that all matters relating to the registration of account executives be delegated to the Association, in order to reduce the administrative burden on the government. 1976 SB Ann. Rep. 33–36. Some of the directors of the Association are former members of the staff of the Securities Bureau.

<sup>44</sup> Issuers desire to have their stock listed on stock exchanges as soon as they meet listing standards, and they make use of the over-the-counter market only as a stepping stone to exchange listing. In 1961, three major stock exchanges established a 'second section' to absorb the over-the-counter market. Tatsuta, *op. cit. supra* n. 3, at 82 n. 14. Stock exchange members are prohibited from dealing in listed stocks off the exchange floor, which makes it impossible for a Third Market to develop except in debt securities. Constitution of the Tokyo Stock Exchange, art. 23.

<sup>45</sup> 'Universal securities company' (*sōgō shōken*) is a common term for a securities firm that has licenses to engage in all types of securities business without any limitation on the amount it can underwrite for each issue; in other words, it is a broker-dealer-underwriter. Autonomous rules were at first agreed upon by the "Big Four" universal securities companies (Nomura, Nikkō, Yamaichi and Daiwa), later joined by eight other such companies (Shinnippon, Nippon Kangyō Kakumaru, Wakō, San'yō, Yamatane, Ōsakaya, Okasan and Daiichi). They established the following rules: Autonomous Rules Concerning Stock Prices (*Kabukakeisei ni kansuru jishu* rule) of March 29, 1973; On Improvement of Stock Watch System (*Kabuka-kanshikikō no seibikakujū ni tsuite*) of June 1, 1973; Agreement Concerning Improvement of Service Regulations on Employees Engaged in Transactions with Corporations (*Hōjinkankei-shain no fukumukitei seibi ni kansuru mōshiwase*) of June 18, 1973; Criteria on New Stock Issues at Market Price (*Jikahakkō-zōshi ni kansuru kangaekata*) of February 10, 1973, as revised on October 1, 1976; and Criteria on Issues of Convertible Debentures (*Tenkanshasai-hakkō ni kansuru kangaekata*) of February 13, 1973, as revised on September 30, 1976. 1974 SB Ann. Rep. 46-48; 1977 SB Ann. Res. 75, 79-80.

<sup>46</sup> CPA Law. as amended by Law No. 85 of 1966, art. 43, art. 46-2. 1967 SB Ann. Rep. 49-51.

<sup>47</sup> CPA Law art. 19, para. 3; art. 46-11, para. 1 and para. 2.

<sup>48</sup> CPA Law art. 46-11, para. 4 and para. 5.

<sup>49</sup> CPA Law art. 46-13.

<sup>50</sup> Members of the Conference Concerning Coordination of Capital Increase are the following: Deputy Minister, Ministry of Finance (chairman); Deputy Minister, Ministry of International Trade and Industry; Deputy Governor, the Bank of Japan; Secretary General, Federation of Economic Organizations; President, Tokyo Stock Exchange; Chairman, Tokyo Stock Exchange; Chairman, Securities Dealers Association of Japan; Chairman, Federation of Bankers Associations of Japan; President, Japan Securities Finance Corporation; Chairman, Life Insurance Association of Japan; and Chairman, Marine and Fire Insurance Association of Japan. Yamaichi Shōken, *Shikinchōtatsu Handbook* (Capital Raising Handbook) 85 n. 1 (1972). For background information about the development of the existing practice, see *id.* at 85 n. 2; Kogayu, *Zōshikiseisochi no teppai ni tsuite* (On Repeal of Restrictive Measures Relating to Capital Increase), No. 381 *Shōji Hōmu* (Commercial Law Review) 6-7 (1966); Kogayu, *Shitsutekei zōshichōsei no jishijōkyō ni tsuite* (On Present Enforcement of Qualitative Coordination of Capital Increase), No. 358 *Shōji Hōmu* 2 (1965). Mr. Kogayu, the last-cited author, was the then associate chief on the Corporation Finance Division, Securities Bureau, Ministry of Finance.

At present, the heads of the underwriting departments of each of the Big Four meet almost every week, and those of twelve other universal securities companies hold monthly meetings, to carry out coordination and to review compliance with their autonomous rules.

<sup>51</sup> By-law on Capital Increase (*Zōshi toriatsukai naiki*) of May 12, 1966. It requires that the ex-right market price of stock of 50 yen par value shall be 60 yen or more, that the issuer shall have been paying dividends at the rate of 10% or more of the par value, and that the net profit return to common stock after tax shall be such as to permit the maintenance of the dividend rate. An exemption may be granted to issuers in regulated industries whose dividend rate is controlled by the government, to financial institutions and in cases where the raising of capital is urgent and highly important.

<sup>52</sup> On Proper Operation of Underwriting Business by Securities Companies (*Shōkengaisha no hikiukegyōmu no tekiseina un'ei ni tsuite*), Ministry of Finance Release (*zōshō*) No. 2677, Nov. 6, 1969 (hereinafter cited as Proper Underwriting Release). This release urges that exemptions be granted with great caution.

<sup>53</sup> Criteria on New Stock Issues at Market Price of October 1, 1976, *supra* n. 45. Its origin dates back to February 10, 1973. 1974 SB Ann. Rep. 8, 16-18. After several amendments

thereto, the current Criteria require, *inter alia*, that the issuer have paid at least five yen per share as dividends in the most recent year; that the issuer had current profit after tax of ten yen or more per share in that year; that the amount of the new issue does not exceed the stipulated ceiling; and that the issuer had already distributed free shares to the shareholders equivalent to at least 20% of the premium obtained from the previous issue.

Before the new issue of 6 million shares at market price by Nippon Gakki (Japan Musical Instruments Corp.) in October 1968, rights offerings at par value used to be a common practice regardless of current market price. Tatsuta, *op. cit. supra* n. 3, at 3. Even after the replacement of this practice by offerings at current market price, issuers persisted in the traditional dividend policy, declaring dividends at the same percentage of the par value as before, which meant a considerable decrease in actual yield. Various interested groups, including the securities industry and institutional investors, argued that issuers should increase the number of outstanding shares by a share distribution and a concurrent transfer of the capital surplus obtained from the premium (the excess of the issue price over the par value) to stated capital as stipulated by article 293-3 of the Commercial Code, in order to increase the total amount of dividends paid to the shareholders. The Criteria on New Stock Issues at Market Price incorporates this argument and requires that any premium obtained be repaid to the shareholders in the abovementioned way within a specified number of years. The Securities and Exchange Council strongly requests that issuers comply with this rule. Securities and Exchange Council, On Change in Shareholder Structure and Way of Capital Market (*Kabunushi-kōsei no henka to shihonshijō no arikata ni tsuite*), May 11, 1976 (hereinafter cited as Way of Capital Market Report), at 12-13.

<sup>54</sup> Proper Underwriting Release, *supra* n. 52; On Administration of Review of Registration Statements (*Yūkashōken-todokeidesho tō no shinsajimu no un'ei ni tsuite*), Ministry of Finance Release (*zōshō*) No. 1144, May 29, 1972 (hereinafter cited as Review Release); On Accomplishment of Business Attitude of Investors First (*Tōshishahon'i no eigyōshisei no tettei ni tsuite*), Ministry of Finance Release (*zōshō*) No. 2211, Dec. 2, 1974 (hereinafter cited as

<sup>55</sup> Way of Capital Market Report, *supra* n. 53, at 26. An underwriter is liable for damage caused by a material misstatement in a registration statement unless he proves that he was not aware of such misstatement and that he took due care; however, due care need not be proven with respect to misstatements in financial statements audited by a CPA. SEL art. 21, para. 1, item 4, and para. 2, item 3. This article is inconsistent with article 17, which imposes liability for use of an untrue prospectus, because article 21 dispenses with the defense's need to prove due care in regard to audited financial statements. The same inconsistency appears between Section 11(b)(3)(C) and Section 12(2) of the U.S. Securities Act of 1933. Kawamoto, *Shihonshijō ni okeru rippōronteki kadai (ge)* (*De lege ferenda Problems of Capital Market, Pt. II*), No. 741 Shōji Hōmu 5 (1976).

<sup>56</sup> 1976 SB Ann. Rep. 83. On December 12, 1974, the Chairman of the JICPA issued a circular to the member accountants to the effect that the auditing accountant of an issuer should investigate and report to the managing underwriter so far as feasible when requested by the latter. Saitō, *Comfort Letter no sakuseiyōryō* (Check Points in Filling Out a Comfort Letter), No. 717 Shōji Hōmu 24, 29 (1975). The model form of a comfort letter is based upon the AICPA's Statement on Auditing Procedure No. 48.

<sup>57</sup> Kaneko, *Hiniuke-shinsa to comfort letter; shōkengaisha no tachiba kara* (Review of Underwriting Issue and Comfort Letter from the Viewpoint of a Securities Company), No. 717 Shōji Hōmu 20, 21 (1975).

<sup>58</sup> The 'propriety' in underwriting demanded by the Securities Bureau (*see, e.g.*, Proper Underwriting Release, *supra* n. 52) is construed to include the underwriter's compliance with the autonomous rules. The Bureau asks the managing underwriter to submit a checklist showing its compliance with the autonomous rules with respect to the pending new issue, and then reviews it.



Quantitative adjustment may be designed primarily for the purpose of preventing the stock market from being depressed by a flood of new issues. Qualitative adjustment, on the other hand, may have two functions: to weed out shady issues, and to attain proper allocation of capital. The latter objective is expressed, both in the autonomous rules and in the Bureau's release as follows: "to adjust new issues taking into account urgency and significance of the use of the proceeds". Criteria on New Stock Issues at Market Price, *supra* n. 45; On Way of Underwriting Business by Securities Companies Under the Current Economic Circumstances (*Tōmen no keizaijōsei no moto ni okeru shōkengaisha no hikiuke-gyōmu no arikata ni tsuite*), Ministry of Finance Release (*zōshō*) No. 3359, Dec. 25, 1973. This release, along with that of the Banking Bureau addressed to financial institutions to the same effect, forms a part of the government's tight money policy to curb total demand.

<sup>59</sup> Criteria of Rating Corporate Debentures Issued by Public Offering (*Kōbo jigyōsaika-kuzuke kijun*); Yamaichi Shōken, *op. cit. supra* n. 50, at 411-13. Seven universal securities companies (*see* n. 45 *supra*) joined the Conference from June 1973 on, encouraged by the report of the Securities and Exchange Council advocating a termination of the Big Four's oligopoly in the underwriting business. Securities and Exchange Council, Way of Bond Market Pursuant to Vicissitude in Domestic and Foreign Economic and Financial Circumstances (*Naigai no keizai-kin'yū-jōsei no henka ni tomonau kōshasaishijō no arikata ni tsuite*), February 5, 1973; 1973 SB Ann. Rep. 75-78; 1974 SB Ann. Rep. 14.

<sup>60</sup> 1974 SB Ann. Rep. 14; 1977 SB Ann. Rep. 10. An expert subcommittee of the Securities and Exchange Council recently made a proposal that the Floation Conference should be dissolved in order to enhance competition. Nippon Keizai Shimbun (Japan Economic Journal), September 29, 1977, at 1.

<sup>61</sup> SEL art. 4, art. 24, art. 24-5. Contents of a prospectus are, as a rule, identical with those of Part I of the registration statement. SEL art. 13, para. 2; Registration Rule, *supra* n. 19, art. 12.

Prior to the 1974 amendments to the Commercial Code, most corporations had accounting periods of a half-year, which required them to file their periodic reports semi-annually. The 1974 amendments introduced a provision (Commercial Code art. 293-5) permitting the board of directors to declare interim dividends (*chūkanhaitō*), and many corporations then shifted to an annual accounting period. In the case of these corporations, a 'periodic report' means an annual report, and they are required to file a semi-annual report as well.

<sup>62</sup> SEL art. 193-2. Until quite recently, a semi-annual report had only to contain summary financial statements that did not need to be audited. However, responding to the Securities and Exchange Council's recommendation that credibility of semi-annual reports be enhanced by participation of CPAs therein, the Financial Accounting Council announced an opinion with regard to interim financial statements on March 29, 1977. Based upon this opinion, the Registration Rule and two other relevant ministerial rules were amended as of August 30, 1977, with the result that semi-annual reports were required to contain interim financial statements prepared in accordance with certain standards and audited by a CPA. Way of Capital Market Report, *supra* n. 53, at 31; No. 799 Shōji Hōmu 41-42 (1977).

<sup>63</sup> SEL art. 10, para. 1; art. 24-2, para. 1; art. 24-5, para. 3.

<sup>64</sup> SEL art. 10, para. 1. Similar sanctions are applicable to tender offer statements (*kōkai-kaisuke todokedesho*). SEL art. 27-2, para. 2.

<sup>65</sup> SEL art. 24-2, para. 2. Since this provision does not apply to semi-annual or current reports, investors are likely to be unaware of the fact that such reports have been amended, unless the investors frequent a public reference room.

<sup>66</sup> SEL art. 11, art. 24-3. The purport of these provisions is that the reckless issuer should be kept from making public offerings until the turmoil caused by its gross misstatement abates. Watanabe *et al.*, Kaisei Shōkentorihihikō No Kaisetsu (Comments on the Amended Securities and Exchange Law) 74 (1971).

<sup>67</sup> Review Release, *supra* n. 54.

<sup>68</sup> Regulation Concerning Solicitation of Proxies for Listed Stock (*Jōjō kabushiki no giketsuken no dairikōshi no kan'yū ni kansuru kisoku*), Securities and Exchange Commission Regulation No. 13 of 1948 (hereinafter cited as Proxy Regulation), art. 6. This regulation, promulgated by the defunct commission (see n. 17 *supra*), has the force of a cabinet order. SEL Supplementary Provisions section 2 (1952). The original Proxy Regulation required that drafts of proxy materials be filed ten days prior to their dissemination to the shareholders. This advance review was discarded in 1955, mainly because of pressure by business interests.

<sup>69</sup> Proxy Regulation, *supra* n. 68, art. 7 prohibits the solicitation of proxies by the use of untrue materials, but there is no express provision authorizing the Finance Minister to publicize misstatements in proxy materials. An injunction is provided for in SEL art. 187.

<sup>70</sup> In addition to the candidate's principal occupations or employment during the last five years and the number of shares he owns, "any (financial) interest relationship the candidate holds or held with the corporation" must be disclosed. Proxy Regulation, *supra* n. 68, art. 2, item 3. In a few exceptional cases, a loan from the corporation to the candidate or fringe benefits granted to him have been described in connection with this requirement. Scholarly interpretation of the requirement is that matters likely to cause a conflict of interest between the director and the corporation must be disclosed. Yazawa, *Giketsuken no Dairikōshi* (Voting by Proxy), No. 119 Kaihō 30 (Tokyo Kabushiki Konwakai) 1961.

<sup>71</sup> Compare SEC Rule 14a-6; Schedule 14A and Schedule 14B; J.I. Case Co. v. Borak, 377 U.S. 426 (1964); Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970); Jennings, *Federalization of Corporate Law: Part Way or All the Way*, 31 Bus. Law. 991, at 1016-19 (1976). Japanese shareholders do not have the right to present proposals for inclusion in the proxy statement, such as is provided in SEC Rule 14a-8.

<sup>72</sup> SEL art. 24-5, para. 2. While a current report or a copy thereof is kept for public inspection at the Securities Bureau, the principal and major branch offices of the issuer, and either the stock exchanges on which the security is listed or the Securities Dealers Association of Japan, if the security is not listed on an exchange, the fact that the report has been filed is not publicized. Therefore, investors have no way to become aware of the filing unless they frequent a public reference room. It is true that facts that are or should be stated in current reports are likely to be reported by news media, but a reasonable estimate of the effect of such facts upon the financial condition of the issuer may be made only by inspecting the filed report. The statute requires only that a current report be filed 'without delay', without specifying any deadline.

<sup>73</sup> Registration Rule, *supra* n. 19, art. 19. See Tatsuta, *op. cit. supra* n. 3, at 116-117.

<sup>74</sup> Way of Capital Market Report, *supra* n. 53, at 31-32.

<sup>75</sup> Request Concerning Timely Disclosure of Corporate Information (*Kaishajōhō no tekijikajji ni kansuru yōsei*), Circular (*tōshō jōkan*) No. 525, June 7, 1974.

Rule 2, para. 1, of the Regulations for Supervision of Listed Securities (*Jōjōyūkashōken kanrikijun*) of the Tokyo Stock Exchange (published in Listing of Securities Regulations of the Tokyo Stock Exchange 22 (1975)) provides as follows:

"The issuer of a listed security shall promptly give notice to the Exchange when one of the following items occurs:

- (1) Dishonor of any bill or check or suspension of any bank account.
- (2) Allegation of initiation of procedure of company reorganization or for initiation of liquidation pursuant to the provisions of law or *de facto* liquidation.
- (3) Suspension of business activity.
- (4) Considerable change in the nature of business.
- (5) Heavy loss from disaster.
- (6) Commencement of legal proceedings which may have influence on the listing of the securities.
- (7) Other serious business problems."

<sup>76</sup> Nojiri, *Kaishajōhō tekijikaiji ni jūjitsu ni tsuite* (On Improving Timely Disclosure of Corporate Information), No. 735 Shōji Hōmu 42, 43 (1976). The Tokyo Stock Exchange delisted the violator, Yoshida Tekkōsho (Yoshida Steel Work, Inc.). 1976 SB Ann. Rep. 472. The Exchange's senior staff lamented that management of listed corporations had little understanding of the importance of timely disclosure and were reluctant to provide such disclosure. Nojiri, *id.*; Sakuma, *Kaishajōhō no tekijikaiji ni kansuru yōsei ni tsuite* (On the Request Concerning Timely Disclosure of Corporate Information), No. 671 Shōji Hōmu 2, 3 (1974).

<sup>77</sup> On Notification to the Exchange and Timely Disclosure of Material Corporate Information (*Jūyōna kaishajōhō no honsho eno tsukoku oyobi tekijikaiji tō ni tsuite*), Circular (*tōshō jōkan*) No. 687, Dec. 22, 1975.

Rule 3 of the Regulations for Supervision of Listed Securities of Tokyo Stock Exchange (published in Listing of Securities Regulations of the Tokyo Stock Exchange 22–23 (1975)) provides as follows: "The issuer of a listed security shall promptly furnish the Exchange on demand with accurate information which the Exchange may require for supervision and regulation of trading in the listed security".

In accordance with the request in the second circular, almost all of the listed corporations appointed senior executives as their spokesmen and registered them with the Exchange. Nojiri, *op. cit. supra* n. 76, at 44.

<sup>78</sup> On the Import of the Requests Concerning Timely Disclosure of Corporate Information (*Kaishajōhō no tekijikaiji ni kansuru yōsei no shushi ni tsuite*), Circular (*tōshō jōkan*) No. 172, April 12, 1976.

<sup>79</sup> Kanzaki, *Tekijikaiji-seisaku no jūjitsu* (Improvement of Timely Disclosure Policy), 1 Gendai Shōhōgaku No Kadai (jō) (Problems of Contemporary Commercial Law Study, in Honor of Dr. Suzuki for his 70th Birthday) 127, 133–34 (1975). Professor Kanzaki suggests that an issuer in violation of the policy be delisted and the directors be liable for damages. *Id.* at 151–52.

<sup>80</sup> Law Concerning Exceptions from the Commercial Code with regard to Auditing Stock Corporations (*Kabushikigaisha no kansa tō ni kansuru shōhō no tokurei ni kansuru hōritsu*), Law No. 22 of 1974, art. 2. A CPA audit of financial statements contained in reports to be filed with the Finance Minister is a different matter, and had been required even prior to the 1974 amendments. See n. 62 *supra*. These financial statements were prepared on the basis of annual accounts approved by the shareholders meeting. The 1974 amendments extended the period between the close of fiscal year and the date of the annual shareholders meeting from two months to three. Commercial Code art. 224-3, para. 2 and para. 3. This means that annual accounts to be presented to the shareholders meeting are prepared and audited simultaneously with financial statements which have to be filed with the Finance Minister. SEL art. 24, para. 1. In order to eliminate inconsistencies between these documents, the Financial Statement Regulation, *supra* n. 29, was amended along with the Regulation governing the annual accounts under the Commercial Code. Regulations Concerning Balance Sheet, Income Statement and Schedules of Stock Corporations (*Kabushikigaisha no Taishakutaishōhyō, Son'ekikeisansho oyobi Fuzokumeisaisho ni kansuru Kisoku*), Ministry of Justice Rule No. 31 of 1963, as amended in 1974 (hereinafter cited as Corporate Accounts Regulation).

<sup>81</sup> Prior to the 1974 amendments, most corporations used to publicize their accounts within approximately one month from the close of the (usually semi-annual) fiscal period. Nojiri, *Jōfōgaisha no Kessanhappyō no Jōkyō to Mondaiten* (Present Situation and Problems of Publicizing Annual Accounts by Listed Corporations), No. 741 Shōji Hōmu 9, 10 (1976).

<sup>82</sup> Ibayashi, *Kaiseishōhō Tekiyōka ni okeru Keidanren no Kessankankei-shorihōshin ni tsuite* (On the Federation of Economic Organizations' Guidelines for Processing Annual Accounts under the Amended Commercial Code), 27 Accounting (*Kigyōkaikai*) 660 (1975). See *id.* at 667–76 for the guidelines issued by the Committee on Economic Laws (*Keizaihōki*

*inkai*) of the Federation of Economic Organizations.

<sup>83</sup> On Request Concerning Publication of Annual Accounts (*Kessanhappyō ni kansuru yōbō ni tsuite*), Circular (*tōshō jōjō*) No. 189, April 26, 1976 and Circular No. 126, April 12, 1977.

<sup>84</sup> Timely Disclosure and Audit (*Timely disclosure to kansa*), JICPA Circular, Feb. 14, 1972.

<sup>85</sup> Way of Capital Market Report, *supra* n. 53, at 31.

<sup>86</sup> Yazawa, *Tekijikaiji-seisaku to Kaishakessan no Kōhyōjiki* (Timely Disclosure Policy and the Time to Publicize Corporate Annual Accounts), No. 737 Shōji Hōmu 2, 5 (1976).

<sup>87</sup> SEL art. 28, para. 1. The term 'securities business' (*shōkengyō*) is defined as "any business involved in one of the following activities by any person other than a bank, trust company, or other financial institution designated by a cabinet rule: (a) sale of securities; (b) sale of securities as an intermediary, broker or agent; (c) commissioning of a sale order to be executed on a securities exchange as an intermediary, broker or agent; (d) underwriting of securities; (e) secondary distribution of securities; and (f) arrangement for a public offering or secondary distribution of securities". SEL art. 2, para. 8. A stock corporation (*kabushikigaisha*) is governed by the Commercial Code, arts. 165 through 456.

<sup>88</sup> Exchange Law (*Torihikishohō*), Law No. 5 of 1893, art. 10; Securities Installment Sales Business Law (*Yūkashōken kappuhambaigyōhō*), Law No. 29 of 1918; Securities Business Control Law (*Yūkashōkengyō torishimarihō*), Law No. 32 of 1938; Securities Underwriting Business Law (*Yūkashōken hikiukegyōhō*), Law No. 54 of 1938.

<sup>89</sup> Law No. 22 of 1947.

<sup>90</sup> See Section 4(C) *infra*.

<sup>91</sup> See the following three publications by the Securities and Exchange Council: On Problems Concerning Broker-Dealers (*Shōkengyōsha ni kansuru shomondai ni tsuite*), Feb. 12, 1964, 1965 SB Ann. Rep. 109; On License System (*Menkyosei ni tsuite*), Oct. 16, 1964, 1965 SB Ann. Rep. 120; and On the Problems of Licensing Broker-Dealers (*Shōkengyōsha no menkyosei tō no mondai ni tsuite*), Dec. 22, 1964, 1965 SB Ann. Rep. 123. Among the arguments for the license system were that broker-dealers should be treated the same as other financial institutions, which were licensed; and that the Finance Minister had no choice but to register a broker-dealer who met the requirements under the registration system. Opponents' arguments, on the other hand, included the points that government intervention without solid criteria would be susceptible to bureaucratic control over the entire economy; and that the Finance Minister had exerted, by way of administrative guidance, controlling power over broker-dealers in a manner similar to that under a license system, and hence there was no need to change from the registration system. The staff of the Ministry of Finance were at first reluctant to press for the revision because of their fear of the eventually heavier responsibility that would accompany their greater authority. Suzuki and Kawamoto, *Shōkentōrihikihō* (Securities and Exchange Law) 79-84 (1968); Miyashita, *Kaisei Shōkentōrihikihō Sei-shōrei no Kaisetsu* (Comments on the Amended Securities and Exchange Law, Cabinet and Ministerial Rules Thereunder), Special Issue No. 1 Bessatsu Shōji Hōmu 3 (1965).

<sup>92</sup> SEL art. 28, para. 2. Tatsuta, *op. cit. supra* n. 3, at 68. A firm having all four types of license is a universal securities company. See n. 45 *supra*.

<sup>93</sup> SEL art. 32, item 1; SEL Enforcement Rule, *supra* n. 7, art. 15. The list of minimum capital requirements is supplied in Tatsuta, *op. cit. supra* n. 3, at 69 n. 5.

<sup>94</sup> SEL art. 31. At the request of the securities industry, the Securities Bureau issued a release designed to clarify the criteria. Its wording, however, remains nonspecific, with the exception of one requirement that the amount of net assets must exceed the amount of stated capital and the indebtedness ratio (aggregate indebtedness divided by net assets) be ten or less. On Matters to Be Considered in Connection with Licensing Securities Business (*Shōkengyō no menkyō ni atari kentōsubeki jikō ni tsuite*), Ministry of Finance Release (*zōshō*) No. 685,

March 23, 1967; 1968 SB Ann. Rep. 28. During the grace period for then-existing broker-dealers between October 1, 1965 and March 31, 1968, the Securities Bureau energetically gave guidance, including advice as to mergers, tailored to each broker-dealer in order to improve its financial status. 1968 SB Ann. Rep. 27.

<sup>95</sup> SEL art. 32.

<sup>96</sup> Suzuki and Kawamoto, *op. cit. supra* n. 91, at 90.

<sup>97</sup> SEL art. 29.

<sup>98</sup> Miyashita, *op. cit. supra* n. 91, at 4. With regard to segregation of broker and dealer functions, the Securities and Exchange Council took the position that it would not pursue drastic measures toward segregation but would try to eliminate hazards deriving from a securities firm's engaging in both broker and dealer businesses. On the Problems of Licensing Broker-Dealers, *supra* n. 91. The Council recently endorsed its 1964 pronouncement. Way of Capital Market Report, *supra* n. 53, at 27-28.

<sup>99</sup> 1968 SB Ann. Rep. 39.

<sup>100</sup> Other sources of administrative control, such as revocation of license, permit or approval, and special reserves required, are summarized in Tatsuta, *op. cit. supra* n. 3, at 71-78. One of the difficulties felt by the Securities Bureau in applying article 58 lies in its abstract wording and supposed requirement of an intent to defraud. Suzuki and Kawamoto, *op. cit. supra* n. 91, at 101 n. 1.

<sup>101</sup> Ministerial Rule Concerning Standards of Soundness for Securities Companies (*Shōken-gaisha no kenzensei no junsoku tō ni kansuru shōrei*), Ministry of Finance Rule No. 60 of 1965 (hereinafter cited as Soundness Rule), art. 1. This rule is, so to speak, a codification of *de facto* standards previously applied in administrative guidance. Suzuki and Kawamoto, *op. cit. supra* n. 91, at 100.

<sup>102</sup> SEL art. 35 and art. 64-3. There have been eight cases of administrative sanctions on account of violations of article 50; all were violations of the Soundness Rule, art. 1, item 3 (*see* n. 101 *supra*). The sanctions were suspension of a part of the business for one to three days.

<sup>103</sup> U.S. NASD Fair Practice Code, Rule 3(2); SEC Rule 15b10-3.

<sup>104</sup> Investors First Release, *supra* n. 54. This release also urges strict conformity with an earlier release with respect to accepting discretionary accounts: On Self-Discipline of Securities Transactions in Discretionary Accounts (*Yūkashōken no baibai-ichininkanjō torihiki no jishuku ni tsuite*), Ministry of Finance Release (*zōri*) No. 926, Feb. 7, 1964. The latter release urges that a securities firm refrain from accepting transactions in discretionary accounts except on the customer's insistent request, notwithstanding the permissiveness of the SEL with respect to such transactions if the firm complies with certain requirements. SEL art. 127; Regulation Concerning Discretionary Accounts of Securities (*Yūkashōken no baibai-ichininkanjō ni kansuru kisoku*), Securities and Exchange Commission Rule No. 15 of 1948. This general discouragement of discretionary accounts reflects the occurrence of disputes in connection with such accounts.

<sup>105</sup> Way of Capital Market Report, *supra* n. 53, at 27.

<sup>106</sup> 1976 SB Ann. Rep. 194. The inspectors were assigned to investigate the situations of, and the details of transactions by, 'peculiar' customers, such as those who invested a huge amount of money, who gained or lost a great deal, who concentrated in dealing in specified stocks, or who only sold or only bought. *Id.*

<sup>107</sup> Rule Concerning Investment Solicitation and Customer Administration by Member Firms (*Kyōkaiin no tōshikan'yū, kokyakukanri tō ni kansuru kisoku*), Fair Practice Code No. 9, Feb. 19, 1975, art. 3. The Rule Concerning Stock Sales and Other Transactions on Over-the-Counter Market (*Tentō ni okeru kabushiki no baibai sonota no torihiki ni kansuru kisoku*), Fair Practice Code No. 1, June 18, 1976, art. 13, prohibits member firms from offering one-sided inducements to purchase over-the-counter stocks and from soliciting inexperienced customers to buy such stocks.

<sup>108</sup> SEL Enforcement Rule, *supra* n. 7, art. 16; Ministerial Rule Concerning Securities Companies (*Shōkengaisha ni kansuru shōrei*), Ministry of Finance Rule No. 52 of 1965 (hereinafter cited as 'Securities Company Rule'), art. 6. Prior to the 1965 amendment, the government used as a standard for measuring the indebtedness of a securities company a type of liquidity ratio which in a simplified form may be described as follows:

$$\frac{\text{current liabilities}}{\text{current assets} - \text{current liabilities}} \leq 20$$

Use of this measure turned out to be ineffective in preventing securities companies from reckless expansion by means of excessive borrowings. In simplified form, the new measure adopted in 1965 may be shown as follows:

$$\frac{\text{aggregate liabilities}}{\text{net assets}} \leq 10$$

This may be translated into an equity ratio of around 9.1% which is vulnerable to a criticism that it is too low. Suzuki and Kawamoto, *op. cit. supra* n. 91, at 120–122. Even before the 1965 amendment, a measure similar to the present one was introduced by way of administrative guidance. On Financial Administration of a Securities Firm (*Shōkengyōsha no zaimukanri tō ni suite*), Ministry of Finance Release (*zōri*) No. 5304, July 5, 1963; 1964 SB Ann. Rep. 190–96. See also Tatsuta, *op. cit. supra* n. 3, at 74.

<sup>109</sup> SEL art. 54, para. 1.

<sup>110</sup> Soundness Rule, *supra* n. 101, art. 2.

<sup>111</sup> Soundness Rule, *supra* n. 101, art. 3.

<sup>112</sup> SEL art. 55.

<sup>113</sup> 1977 SB Ann. Rep. 183. See also text *supra* at n. 21.

<sup>114</sup> 1977 SB Ann. Rep. 182.

<sup>115</sup> *Id.* at 183.

<sup>116</sup> *Id.* at 184.

<sup>117</sup> Each stock exchange has its Inspection Rule (*kensa kitei*), based upon the provisions of its constitution authorizing the exchange to inspect its member firms. The Rule enumerates matters to be inspected in detail. It also provides that the exchange is to give notice in advance to a firm that is about to be inspected. The Securities Dealers Association of Japan has an Audit Rule (*kansa kisoku*), also based upon its constitution. Audit does not differ from inspection and is carried out mainly by checking the manner of keeping securities deposited by customers.

<sup>118</sup> 1977 SB Ann. Rep. 108, Table 81 (1).

<sup>119</sup> 1972 SB Ann. Rep. 106; 1977 SB Ann. Rep. 107.

<sup>120</sup> 1977 SB Ann. Rep. 110. The Secondary Market Division is equipped with a displayer for QUICK (Quotation Information Center K.K.), and automated quotation service system, but the securities exchange controllers' rooms are not.

<sup>121</sup> As for 'peculiar' customers, see n. 106 *supra*.

<sup>122</sup> 1976 SB Ann. Rep. 123.

<sup>123</sup> 1977 SB Ann. Rep. 110.

<sup>124</sup> *Id.* at 107.

<sup>125</sup> See n. 45 *supra*.

<sup>126</sup> 1977 SB Ann. Rep. 107, 110; On Improvement of Stock Watch System, *supra* n. 45.

<sup>127</sup> 1977 SB Ann. Rep. 108, Table 71 (3); 110.

<sup>128</sup> SEL art. 125, para. 1 and para. 2; art. 126; art. 197, item 2. See Tatsuta, *op. cit. supra* n. 3, at 87.

<sup>129</sup> See nn. 6–8 *supra*, and Tatsuta, *op. cit. supra* n. 3, at 118–19.

<sup>130</sup> For example, the Nomura Securities Company was required to suspend its business in connection with a public offering of convertible debentures by Nippon Tsuun in 1966. The

Bureau acted similarly with respect to Nikko Securities Company and Yamaichi Securities Company in connection with public offerings of shares by Yamashita Shinnippon Steamline and Showa Marine in 1967. The anti-manipulation provisions of Article 125 were resorted to in the Kyōdō Shiryō Case, see Section V(C) *infra*. On the Soundness Rule, see n. 101 and text at nn. 110, 111 *supra*.

<sup>131</sup> The City Code on Take-overs and Mergers ('City Code'), issued by the City Working Party, is administered and enforced by the Panel on Take-overs and Mergers, a body representative of those using the United Kingdom securities markets. According to the Introduction to the City Code, the duty of the Panel is the enforcement of good business standards, not the enforcement of law. Copies of the City Code may be obtained from the Panel at P.O. Box No. 226, The Stock Exchange Building, London EC2P2JX, England.

<sup>132</sup> Repurchase by an issuer of its own shares is prohibited. Commercial Code art. 210. Tatsuta, *Patterns of Restricting Share Reacquisitions by Corporations*, 6 Law in Japan: An Annual 128 (1973). The Code says nothing about purchases by a subsidiary of shares in its parent corporation, nor is there any case law on this point. Scholarly interpretation is divided as to what subsidiaries are prohibited from purchasing shares in the parent. Tatsuta, *Kogaisha ni yoru Oyagaisha-kabushiki no Shutoku* (Subsidiaries' Purchase of Shares in the Parent Corporation), 3 Gendai Shōhōgaku No Kadai (ge) (Problems of Contemporary Commercial Law Study, in Honor of Dr. Suzuki for his 70th Birthday) 1459 (1975). Proposed amendments to the Commercial Code have a provision that a subsidiary whose majority shares are held by its parent corporation shall not acquire shares in the latter. Ministry of Justice, Tentative Draft for Amending the Stock System (*Kabushikiseido ni kansuru kaisei-shian*) III 7 (May 1977). One of the universal securities companies makes it its own rule that the firm refrain from accepting an order by a subsidiary where the parent's holding therein exceeds 70% to 80%. Nomura Securities Company, Underwriting Dept., *Jika finance ni kansuru ryūijikō* (Check List for New Issues at Market Price) 4 (1976). This brochure is for the firm's internal use.

<sup>133</sup> Autonomous Rules Concerning Stock Prices, *supra* n. 45; 1974 SB Ann. Rep. 48.

<sup>134</sup> Nomura Securities Company, Underwriting Dept., *op. cit. supra* n. 132, at 4.

<sup>135</sup> On Improvement of Stock Watch System, *supra* n. 45; 1974 SB Ann. Rep. 46.

<sup>136</sup> Nomura Securities Company, Underwriting Dept., *op. cit. supra* n. 132, at 5.

<sup>137</sup> SEC v. Texas Gulf Sulphur Co., 401 F. 2d 833 (2d Cir. 1968), *commented on by* Tatsuta, 1970 *Amerikahō* (American law) 100; 446 F. 2d 1301 (2d Cir. 1971), *commented on by* Takeuchi, 1972 *Amerikahō* 370; Merrill Lynch, Pierce, Fenner and Smith, Inc., Securities Exchange Act Release No. 8459 (Nov. 25, 1968); In the Matter of Investors Management Co. (SEC), CCH Fed. Sec. L. Rep. [para.] 78, 163 (1971), *commented on by* Tatsuta, 1973 *Amerikahō* 299. A great number of comments on these cases have appeared in addition to those cited here.

<sup>138</sup> SEL art. 189, modeled after section 16(b) of the U.S. Securities Exchange Act of 1934.

<sup>139</sup> SEL art. 188, modeled after section 16(a) of the U.S. Securities Exchange Act of 1934. See Yazawa, *The Legal Structure for Corporate Enterprise: Shareholder-Management Relations under Japanese Law*, Law in Japan 547, 557 (Von Mehren ed. 1963). This repeal was a stain on the history of Japanese securities regulation. Takeuchi, *Naibusha torihiki* (Insider Trading), 41 *Shōken Kenkyū* (Study on Securities) 139 (1975).

<sup>140</sup> Shokusan Jūtaku Co., Ltd., a house construction company, brought an action against its former chairman to recover his short-swing profits of more than 1.1 billion yen. The chairman had been arrested on the charge of tax evasion in connection with his income, totaling approximately 3.8 billion yen, derived from dealings in the company's stock. *Yomiuri shimbun* (Yomiuri Journal), Sept. 4, 1973, at 18.

<sup>141</sup> Way of Capital Market Report, *supra* n. 53, at 32, 33.

<sup>142</sup> On Prevention of Mishaps (*Jikobōshi tō ni tsuite*), Ministry of Finance Release (*zōshi hi*) No. 452, Feb. 24, 1971; No. 553 *Shōji Hōmu* 32 (1971). Contents of the release have been kept confidential.

<sup>143</sup> On Dealings by Issuers' Related Persons in the Stock in the Issuer (*Jōjōgaisha no kankeisha ni yoru jishakabu no baibai-torihiki ni tsuite*), Circular (*tōshō jōkan*) No. 1621, Nov. 17, 1972.

<sup>144</sup> On Adequate Disclosure of Financial Information and Dealings in the Issuers' Stock (*Zaimunaiyō no tekiseikaiji oyobi jishakabu-baibai ni tsuite*), Circular (*tōshō jōkan*) No. 120, Feb. 16, 1973.

<sup>145</sup> On Improvement of Stock Watch System, *supra* n. 45; Agreement Concerning Improvement of Service Regulations on Employees Engaged in Transactions with Corporations, *supra* n. 45. See also text at nn. 125-127 *supra*.

<sup>146</sup> Inquiry on Corporation Law Reform (*Kaishahō kaisei ni kansuru ikenshōka*), circulated by the Ministry of Justice to various organizations on June 12, 1975, contains the question (in III 6): "What do you think of the argument that the corporation law should have a provision preventing management from taking advantage of inside information?" In the answers, pros outnumbered cons by a small margin. Inaba, Analysis of Opinions Concerning the Corporation Law Reform (*Kaishahō kaisei ni kansuru kakukai iken no bunseki*), No. 728 Shōji Hōmu 18 (1976). The writer introduced to the Conference on Economic Law held in October 1976 a proposal for an insider trading statute, modeled, with some modifications, after The American Law Institute Federal Securities Code, Tentative Draft No. 2, sections 1303, 1402 (f), 1409 (1973). Tatsuta, *Naibusha-torihiki ni kansuru hōritsu-shian to teianshushi* (A Proposal for an Insider Trading Statute and Comments Thereon), No. 746 Shōji Hōmu 2 (1976); Tatsuta, *Naibusha-torihiki no kōka ni kansuru rippōronteki kōsatsu* (*De lege ferenda* Reflections on Relief as to Insider Trading), Kigyōhō No Kenkyū (Studies on Business Law, in Honor of Dr. Ohsumi for his 70th Birthday) 698 (1972).

<sup>147</sup> 1973 SB Ann. Rep. 31, Table 14. This stock rise has been attributed to (1) the unexpectedly good performance of corporations that was publicized in that month, coupled with even better projections for the subsequent half-year period; and (2) the attainment of 1000 in the NYSE Dow-Jones Industrial Average on November 14, 1972, reflecting the prospect of a Vietnam ceasefire. *Id.* at 36.

<sup>148</sup> *Id.* at 36. See also n. 21 *supra* with respect to securities companies under direct control of the Bureau's head office.

<sup>149</sup> *Id.* at 37. The Bank of Japan gave similar guidance to the commercial banks. During the period of easy money, many corporations had invested their idle funds in stocks, shifting from their investments in land which had led to rocketing land prices and ultimate enactment of a special discouraging surtax statute to ease the public's harsh burden; also, banks had discouraged the repayment of loans, and had made a tacit threat not to lend anew when needed to those who insisted on making repayment. Most conspicuous were the giant trading companies, some of which made profits from dealing in stocks in amounts comparable to those of a large broker-dealer. This hectic corporate investment race gave rise to serious economic, social and political problems. Individuals' shareholdings, which had been constantly decreasing from over 60% in 1950 to 39.93% in 1960, reached the bottom at 32.71% in 1972 (33% in 1976). 1977 SB Ann. Rep. 98 Table 65(1); Zenkoku Shōkentanishō (All Stock Exchanges in Japan), 1976 Kabushiki Bumpujōkyō Chōsa (Survey of Shareholdings), Table 3 at 9 and Chart 2 at 10 (1977). The embarrassing effects of this phenomenon upon the stock market, corporate management and the economy as a whole forced the Securities and Exchange Council to consider methods of remedying the distortion. Way of Capital Market Report, *supra* n. 53. Notwithstanding the writer's disagreement with several aspects of the report, it moves in the right direction by combining several approaches, including regulation of reciprocal shareholdings and elimination of double taxation. *Id.* at 9, 16.

Another aftermath of the investment race was the tightened Anti-Monopoly Law. In addition to the previous overall ban on holding companies whose sole purpose was the control of other corporations, and restrictions on corporate acquisitions of shares which might have



anticompetitive effects, the 1977 amendments (though retreating from the original proposal by the Fair Trade Commission announced in 1974) introduced several new provisions which presumably have had effects upon the stock market. These new provisions include one that limits the aggregate value of shares that may be owned by the giant non-financial corporations to their stated capital or net assets, whichever is higher, and another that reduces the limit on share ownership by a financial institution (excluding insurance companies) in another corporation from 10% to 5% of the total outstanding shares of the issuer, thus returning to the pre-1953 amendment standard. Law Concerning Prohibition of Private Monopoly and Security of Fair Trading (*Shitekidokusen no kinshi oyobi kōseitōrihiki no kakuho ni kansuru hōritsu*), Law No. 54 of 1947, as amended by Law No. 63 of 1977.

<sup>150</sup> 1973 SB Ann. Rep. 37. As to bonds for margin transactions, see Tatsuta, *op. cit. supra* n. 3, at 99.

<sup>151</sup> 1973 SB Ann. Rep. 37. As a result of the increase by the stock exchanges in the margin rate requirement, broker-dealers had more cash, which was itself a new problem. In order to absorb this additional cash, the Ministry of Finance amended the Soundness Rule, *supra* n. 101, on January 16, 1973, to add a provision requiring that cash deposited from customers in connection with margin and when-issued transactions be kept separate from other assets, safely and in liquid form, and requested member firms to deposit a certain percentage of cash bonds with the respective stock exchanges. On Handling Deposited Bonds in Connection with Margin Transactions (*Shin'yō-torihiki ukeire-hoshōkin no toriatukai ni tsuite*), Ministry of Finance Release (*zōshō*) No. 111, Jan. 16, 1973.

<sup>152</sup> Tokyo Securities Dealers Association, Circular (*tōshōkyō* (*sō*) 48) No. 16, Jan. 9, 1973; Tokyo Stock Exchange, Circular (*tōshōsō*) No. 2, Jan. 9, 1973.

<sup>153</sup> Tokyo Securities Dealers Association, Circular (*tōshōkyō* (*sō*) 48) No. 22, Feb. 21, 1973; Tokyo Stock Exchange, Circular (*tōshōsō*) No. 20, Feb. 21, 1973.

<sup>154</sup> Minutes of the Finance Committee, House of Representatives, 71st Diet (No. 9, Feb. 28, 1973) at 105.

<sup>155</sup> 1973 SB Ann. Rep. 36; 1974 SB Ann. Rep., Table 8 at 21.

<sup>156</sup> 1963 SB Ann. Rep., Table 100 at 91; 1964 SB Ann. Rep. 43-46, Table 17 at 361; Arakawa, Shōken Kyōkō Zengo (Before and After the Stock Crisis) 138-39 (1967).

<sup>157</sup> This oversupply was brought about by several causes. The economic prosperity triggered by the rapid growth in the late 1950s stimulated a vast demand for funds, a part of which was raised by stock issues. The effect was to increase the aggregate amount of stated capital in corporations listed on the first section of the Tokyo Stock Exchange by 6.1 times during the decade between 1956 and 1964. Many upper-middle issuers vied with each other to go public in order to be listed on exchanges, and underwriters waged cut-throat competition to unearth those golden eggs. Investment trusts also expanded by nearly 10 times during the same decade, reaching for increases in size for competition's sake. Once economic growth slowed down, these factors, and increased reciprocal shareholding among corporations, all impacted heavily upon the stock market at about the same time during the last years of the decade ending in 1964. Arakawa, *op. cit. supra* n. 156, at 28, 109, 121, 139.

<sup>158</sup> The initial amount of the stated capital was 2.5 billion yen, which rose to 30 billion yen in November of the same year through four new issues, with 57 regional banks, 7 trust banks, 20 life insurance companies and 15 additional securities companies joining as shareholders. 1965 SB Ann. Rep. 62. The reason why city banks took the initiative for this project was that they had begun to find it difficult to meet the demand for funds by industry in the face of a tight money tendency. In that situation, these banks had either to reduce the money demands they were apparently facing or to attempt to collect their loans (which would then likely become bad debts because the banks had loaned in 1963 about 60% more than in the previous year). Arakawa, *op. cit. supra* n. 156, at 141.

<sup>159</sup> 1965 SB Ann. Rep. 62. The declared business policy was in accordance with the quali-

fication attached to the license granted the corporation.

<sup>160</sup> *Id.* at 63. As regards a securities finance company, see Tatsuta, *op. cit. supra* n. 3, at 100.

<sup>161</sup> 1970 SB Ann. Rep. 35.

<sup>162</sup> 1965 SB Ann. Rep. 64. A civil partnership (*kumiai*) is provided for in the Civil Code, arts. 667 through 688.

<sup>163</sup> Dealings were effected by way of so-called *baikai*, i.e., a matching of the Association's buy order with an investment trust's sell order through a single exchange member or a matching of the buy order with the member's own offer at the price at which the last sale of the security was executed on the exchange. Stock exchanges granted privileged commission rates, at one-half of the ordinary rates, for sales by investment trusts, and provided commission-free transactions between the Association and its partners. 1965 SB Ann. Rep. 66. As for *baikai* and the subsequent ban thereof, see Tatsuta, *op. cit. supra* n. 3, at 92-93.

<sup>164</sup> 1965 SB Ann. Rep. 67; 1970 SB Ann. Rep. 34.

<sup>165</sup> The Holding Association's profits were approximately 45 billion yen, from which 12.3 billion yen was contributed to a newly-formed foundation, Capital Market Promotion Foundation (*Shihonshijō Shinkō Zaidan*), whose purpose is to aid the sound development of the capital market by giving assistance to activities that promote the protection of investors and the growth of the securities market. 1969 SB Ann. Rep. 12-13. The Foundation has awarded financial support to scholars, including the writer, regardless of their prior views with respect to the pools. Out of the approximately 34 billion yen surplus held by Joint Securities at the time of its liquidation, 28 billion yen were contributed to another newly-formed foundation, *Nihon Kyōdō Shōken Zaidan* (Japan Joint Securities Foundation), which has for its purpose the support of activities that promote the protection of the general public and related research by public organizations in the securities, banking and insurance industries. 1971 SB Ann. Rep. 65-66.

<sup>166</sup> 1965 SB Ann. Rep. 62.

<sup>167</sup> *Id.* at 64.

<sup>168</sup> Customers coming to the firm's offices, usually 3,000 to 4,000 a day, increased to 14,345 on May 22 and 20,338 on May 28. Anonym, *Shōkenkai no Shin'yōfuan to Kinkyū-kyūsai no Hōteki Mechanism* (Credit Disturbance in Securities Industry and Legal Mechanism of Emergent Redress). No. 355 *Shōji Homu* 23, 24 (1965). These customers requested cancellation of their investment trust contracts, investment deposit (*un'yō-azukari*) contracts and safety deposit contracts. As to investment deposit and its final ban, see Tatsuta, *op. cit. supra* n. 3, at 72 n. 19.

<sup>169</sup> 1967 SB Ann. Rep. 19. The Bank of Japan Law, Law No. 67 of 1942, art. 25, provides:

The Bank of Japan may, with the permission of the competent Minister, undertake such businesses as are necessary for the maintenance and fostering of the credit system.

<sup>170</sup> 1967 SB Ann. Rep. 19; Anonym, *op. cit. supra* n. 168, at 23, 25; Arakawa, *op. cit. supra* n. 156, at 159.

<sup>171</sup> 1967 SB Ann. Rep. 19-20. Ōi Securities, predecessor of the present Wakō Securities Company, was also granted special loans amounting to 5.3 billion yen, and followed a similar course. *Id.* at 21.

<sup>172</sup> So did the new Ōi, i.e., Wakō. 1970 SB Ann. Rep. 32-34.

<sup>173</sup> 1967 SB Ann. Rep. 22. Investment deposits (*un'yō-azukari*, no. 168 *supra*), which provided securities companies with a considerable amount of funds for their dealer business, were banned in the end. 1970 SB Ann. Rep. 35-39.

<sup>174</sup> Although not a few corporations became insolvent and failed during the recession of the mid-1960s, the name San'yō Steel has been referred to whenever one speaks of window-dress-

ing, because of the size of the corporation, the large amounts involved in the falsified figures (comparable to the McKesson and Robbins scandal: SEC Accounting Series Release No. 19 (1940)), and the great impact on many other corporations and individuals. A large number of subcontractors went down like ninepins, and their employees were also affected seriously. This case even triggered amendments to the Corporate Reorganization Law (*Kaishakōsei-hō*), Law No. 172 of 1952, as amended by Law No. 88 of 1967, a counterpart of Chapter X of the U.S. Bankruptcy Act. Matsuda, *Kaishakōsei-hō* (Corporate Reorganization Law) 2 (rev. ed. 1976).

<sup>175</sup> 1966 SB Ann. Rep. 63; Nippon Keizai Shimbun, *Shōkenbu* (Japan Economic Journal, Securities Dept.), *Funshoku Kessan* (Window-dressing Accounting) 14–15 (ed. 1966); Kawamoto and Kanzaki, '*San'yōkō*' *Kaishakōsei-jiken no Hōteki Kentō* (Legal Study on San'yō Steel Corporate Reorganization Case), No. 355 *Shōji Hōmu* 2–3 (1965).

<sup>176</sup> Nippon Keizai Shimbun, *Shōkenbu*, *op. cit. supra* n. 175, at 18.

<sup>177</sup> SEL art. 200, item 1; art. 205, item 2-2. By virtue of the 1966 amendments, the crime of making untrue statements in a periodic report came to be governed by article 197, item 1-2, which has heavier penal sanctions.

<sup>178</sup> The disciplinary action was publicized pursuant to the CPA Law art. 34, para. 3. 1946 SB Ann. Rep. 63. The CPA Law was also amended (Law No. 85 of 1966) to improve the CPA system. Galvanized by the San'yō Steel scandal, the Securities Bureau tightened its review of financial statements filed with it and found several other cases of untrue statements. It suspended the business of 16 CPAs for periods of from one to three months at the end of 1966. 1967 SB Ann. Rep. 46.

<sup>179</sup> Harada (Reorganization trustee for San'yō Tokushuseikō K.K.) v. Ogino *et al.*, 17 *Kakyū Minshū* (Lower Court Reporter) 222 (Kobe Dist. Ct., Himeji Branch, April 11, 1966).

<sup>180</sup> 1970 SB Ann. Rep. 64.

<sup>181</sup> *Id.*

<sup>182</sup> SEL art. 187.

<sup>183</sup> 1970 SB Ann. Rep. 64. The Bureau makes the poor excuse that it did not intend to help accelerate the offering. *Id.*

<sup>184</sup> SEL art. 10, para. 1.

<sup>185</sup> 1973 SB Ann. Rep. 44–46.

<sup>186</sup> *Id.* at 46. Relevant provisions are: SEL art. 125, para. 2 (prohibition of manipulation), para. 3 (restriction on stabilization), and art. 197, item 2 (penal sanction for violation of art. 125); Commercial Code art. 210 (restriction on repurchase by a corporation of its own shares) and art. 489, item 2 (penal sanction for violation of art. 210).

<sup>187</sup> 1973 SB Ann. Rep. 46. The action was based on SEL art. 35, and the substantive provision claimed to be violated was the Soundness Rule, art. 1, item 3. *See text supra* at n. 101.

<sup>188</sup> 1973 SB Ann. Rep. 46.

<sup>189</sup> 1975 SB Ann. Rep. 50–51; Kanzaki, *Nihon Netsugaku Jiken no Hōteki Kentō* (Legal Study on Nihon Netsugaku Case), No. 676 *Shōji Hōmu* 2–4 (1974).

<sup>190</sup> Kanzaki, *op. cit. supra* n. 189, at 8. The stock was priced at 15 yen on August 21, just prior to its delisting. *Id.* at 2.

<sup>191</sup> *Japan v. Ōkuma et al.*, No. 780 *Shōji Hōmu* 30 (Osaka Dist. Ct., June 28, 1977). They were convicted of illegal distribution of dividends and bonuses (Commercial Code art. 489, item 3); special misappropriation (Commercial Code art. 486, para. 1); repurchase by the corporation of its own shares (Commercial Code art. 489, item 2); untrue entries in periodic reports (SEL art. 197, item 1-2); and manipulation (SEL art. 125, para. 3; art. 197, item 2).

<sup>192</sup> 1975 SB Ann. Rep. 50.

<sup>193</sup> 1975 SB Ann. Rep. 51–52. The statutory provisions applied are the same as those cited in n. 187 *supra*.

<sup>194</sup> 1975 SB Ann. Rep. 52. Another penal procedure, involving window-dressing and manipulation by Tokyo Tokei Seizō Co., Ltd., a manufacturer and distributor of clocks, foods and sporting goods, has been reported. 1976 SB Ann. Rep. 71–73; *Japan v. Satō et al.*, No. 764 Shōji Hōmu 28 (Tokyo Dist. Ct., Dec. 24, 1976).

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